

**Meeting:** International Public Sector Accounting Standards Board  
**Meeting Location:** Toronto, Canada  
**Meeting Date:** September 20–23, 2016  
**From:** John Stanford

## Agenda Item 4

**For:**  
 Approval  
 Discussion  
 Information

### REVENUE AND NON-EXCHANGE EXPENSES

<b>Project summaries</b>	<p><b>Revenue</b></p> <p>The aim of the 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><b>Non-Exchange Expenses</b></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> <p><i>Scope</i></p> <p>This project will consider issues related to provision of non-exchange transactions, except for social benefits.</p>	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Project management</b>	<a href="#">Instructions–June 2016 meeting and before</a>	<a href="#">4.1.1</a>
	<a href="#">Decisions–June 2016 meeting and before</a>	<a href="#">4.1.2</a>
	<a href="#">Project roadmap</a>	<a href="#">4.1.3</a>
<b>Decisions required at this meeting</b>	Structure of Consultation Paper–Approve	4.2.1
	Performance Obligations and Enforceability	4.2.2

<b>Other supporting items</b>	CP, Chapter 1, Introduction	4.3.1
	CP, Chapter 2	4.3.2
	CP, Chapter 3	4.3.3
	CP, Chapter 4	4.3.4
	CP, Chapter 5	4.3.5
	Appendix A	4.3.6

### INSTRUCTIONS UP TO JUNE 2016 MEETING

Meeting	Instruction	Actioned
June 2016	The IPSASB instructed staff to base the revised CP for review at the next meeting on the new structure agreed at the June 2016 meeting.	Papers 4.2.1, 4.3.1-4.3.6
June 2016	The IPSASB instructed that the revenue section of the CP should focus on whether extending the performance obligation approach in IFRS 15 could solve some of the issues in IPSAS 23.	Paper 4.3.3
June 2016	The IPSASB instructed staff that the term “symmetry” should not be used, and that an alternative term, such as “consistency of approach” should be used instead.	Across all papers
June 2016	The IPSASB instructed staff that the CP should articulate an awareness of the broader implications of the issues but that the focus should be on the following three areas identified by the IPSASB as those where a public interest deficit exists: <ul style="list-style-type: none"> <li>• Gap in current literature related to non-exchange expenses;</li> <li>• Practical issues related to IPSAS 23; and</li> <li>• Updating revenue guidance to converge with IFRS 15.</li> </ul>	Papers 4.3.1-4.3.6
March 2016	The IPSASB instructed staff that the description of categories for revenue recognition should not use the terms exchange or non-exchange in the performance obligation section of the CP.	
March 2016	The IPSASB requested staff to explore the use of an alternative term or terms instead of “customer”.	
March 2016	The IPSASB instructed staff to develop examples of transactions between public sector and private sector entities.	
December 2015	The IPSASB agreed that the performance obligation approach needs to take a broad view of binding arrangements and their enforceability in the public sector, noting that specific legislative requirements can give rise to performance obligations and that enforceability is not just through legal means.	
September 2015	The IPSASB agreed that the performance obligation approach and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Transfers and Taxes)</i> , approach should be applied to examples of transactions, so that each approach could be compared and contrasted.	
September 2015	A performance obligation approach should be explored, using the definition in IFRS 15, <i>Revenue from Contracts with Customers</i> , as the starting point with appropriate modifications for the public sector	

Revenue and Non-Exchange Expenses (Instructions up to June 2016 meeting)  
*IPSASB Meeting (September 2016)*

<b>Meeting</b>	<b>Instruction</b>	<b>Actioned</b>
September 2015	The IPSASB directed that the issue of recognition of particular transactions should be discussed with the Social Benefits project staff.	
June 2015	The IPSASB instructed staff to consider whether, for those revenue transactions where the other side of the transaction is a non-exchange expense within the scope of the non-exchange expenses project, there should be symmetrical accounting.	
June 2015	The IPSASB instructed the revenue project staff to work closely with the non-exchange expenses project staff, where the projects intersect.	
June 2015	The IPSASB instructed staff to consider the issues that have been raised in respect of IPSAS 23 and look to address those issues for revenue transactions that do not have a performance obligation, rather than starting from scratch.	

### DECISIONS UP TO JUNE 2016 MEETING

Date of Decision	Decision
June 2016	The IPSASB agreed that the CP will ask constituents if they are aware of any other implementation issues with IPSAS 23.
June 2016	The IPSASB decided that tax expenditures is beyond the scope of the Non-Exchange Expenses project but will be noted as a potential project for inclusion in the next work plan consultation.
June 2016	The IPSASB decided to request comments from constituents on whether extending the performance obligation approach in IFRS 15 could solve some of the issues in IPSAS 23. There will be a reference to the need to update IPSAS 9 and IPSAS 11 to maintain convergence with IFRS 15.
March 2016	The IPSASB confirmed that Statutory Payables and Statutory Receivables would be considered respectively in the Non-exchange Expenses and Revenue projects.
March 2016	The IPSASB agreed IAS 20 was not a good basis for guidance on revenue recognition because it is not consistent with either the IPSASB's Conceptual Framework or the IASB's current Conceptual Framework.
March 2016	The IPSASB agreed to combine the revenue and non-exchange expenses TBGs into a single TBG. This would be reviewed after the CP stage.
March 2016	The IPSASB agreed with the use of the cost of fulfillment measurement basis for non-exchange expenses.
December 2015	The IPSASB agreed to develop a single Consultation Paper covering both revenue and non-exchange expenses. The paper would address both the exchange/non-exchange and the performance obligation/no performance obligation approaches.
December 2015	The IPSASB agreed that a consultation paper phase is required for both the revenue and non-exchange expenses projects.
June 2015	The performance obligation approach in IFRS 15 is appropriate for accounting for some public sector revenue transactions.
March 2015	The IPSASB approved the project briefs for the revenue and non-exchange expenses projects

# Agenda Item

## 4.1.3

### REVENUE AND NON-EXCHANGE EXPENSES PROJECTS ROADMAP

Meeting	Objective: IPSASB to consider:
September 2016	<ol style="list-style-type: none"> <li>1. Discussion of Issues</li> <li>2. Review partial draft of proposed CP</li> </ol>
December 2016	<ol style="list-style-type: none"> <li>1. Review of proposed CP</li> <li>2. Approval of CP</li> </ol>
March 2017	Consultation period
June 2017	
September 2017	<ol style="list-style-type: none"> <li>1. Review of Responses</li> <li>2. Initial discussion on issues raised</li> </ol>
December 2017	<ol style="list-style-type: none"> <li>1. Discussion of issues raised</li> <li>2. Review first (partial) draft of proposed Exposure Drafts (number to be agreed)</li> </ol>
March 2018	<ol style="list-style-type: none"> <li>1. Review of draft EDs</li> </ol>
June 2018	<ol style="list-style-type: none"> <li>1. Review of draft EDs</li> <li>2. Approval of EDs</li> </ol>
September 2018	Consultation period
December 2018	
March 2019	<ol style="list-style-type: none"> <li>1. Review of Responses</li> <li>2. Initial discussion on issues raised</li> </ol>
June 2019	<ol style="list-style-type: none"> <li>1. Discussion of issues raised</li> <li>2. Review first (partial) draft of proposed IPSASs</li> </ol>
September 2019	<ol style="list-style-type: none"> <li>1. Review of draft IPSASs</li> </ol>
December 2019	<ol style="list-style-type: none"> <li>1. Review of draft IPSASs</li> <li>2. Approval of IPSASs</li> </ol>

**Structure of Consultation Paper****Questions**

1. The IPSASB is asked to agree the structure of the Consultation Paper.

**Detail**

2. At the June 2016 meeting the IPSASB provided instructions for the structure of the paper. The main change from the previous outline structure was that chapters on revenue and non-exchange expenses should be drafted including discussion of both a revised performance and a revised IPSAS 23 approach. Staff has modified the structure to address non-contractual/statutory receivables (statutory receivables) and non-contractual/statutory payables (statutory payables) in a final Chapter 5 on Measurement. This chapter primarily deals with subsequent measurement, which is not currently addressed in the IPSAS literature for statutory receivables – IPSAS 23 deals with
3. The revised structure is:
  - Chapter One: Introduction
    - Drivers, Scope and Structure
  - Chapter Two: Current Revenue Recognition Standards
    - IPSASB Literature
      - IPSAS 9 and 11
      - IPSAS 23
      - IFRS 15
  - Chapter Three: Recognition Options for Public Sector Specific Revenue Transactions
    - The Public Sector Performance Obligation Approach
    - The Exchange/Non-Exchange Approach – Revised IPSAS 23
  - Chapter Four: Non-Exchange Expenses – Initial Recognition
    - Scope
    - Expanded IPSAS 19 Approach
    - Public Sector Performance Obligation Approach
    - Reverse IPSAS 19 Approach
  - Chapter Five Measurement
    - Non-Contractual/Statutory Receivables
    - Non-Contractual/Statutory Payables
4. Currently the only appendix include is a summary of interviews with preparers. Further appendices will be developed for the December meeting.

5. The Task Based Groups on Revenue and Non-Exchange Expenses have indicated that they broadly support the revised structure.
6. Following comments by the CAG the classification of public sector transactions in Chapter 2, so that transactions with no performance obligations are classified as Category a transactions and commercial transactions which meet all the characteristics required to be within the scope of IFRS 15 are classified as Category C transactions. This revision acknowledges that some of the most financial significant transactions do not have performance obligations,

**Decision required**

7. Does the IPSASB support the revised structure? If not, the IPSASB is asked to provide instructions on further revisions to the structure



### Performance Obligations and Enforceability

#### Questions

1. The IPSASB is asked to agree meaning of the term “enforceable” in the context of the Public Sector Performance Obligation Approach.

#### Detail

2. One of the aspects of the Public Sector Performance Obligation Approach discussed in Chapter 3 of the draft Consultation Paper is enforceability. Chapter 3 identifies the following characteristics of a public sector performance obligation:
  - *The performance obligations are established through legal and equivalent binding arrangements*
  - *The agreed performance obligations in the arrangement are enforceable*
3. The first step in the five-step revenue recognition model in IFRS 15, *Revenue from Contracts with Customer*, is the entity identifies the contract with the customer. Because IFRS 15 deals with contractual arrangements enforceability will be effected through commercial law in a particular jurisdiction – which is likely to be the law of contract (or equivalent). The Basis for Conclusions of IFRS 15 does acknowledge that certain terms may be implied through business practice rather than implied.<sup>1</sup> However, Staff do not think that the acknowledgement of an implied term negates the fundamental point that arrangements within the scope of IFRS 15 are enforceable, i.e. both parties to the contract have legal redress in the event of a breach
4. The Framework identifies two types of present obligation that give rise to liabilities – legally binding obligations and non-legally binding obligations. The Framework acknowledges that “there are jurisdictions where government and public sector entities cannot enter into legal obligations, because for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework.”
5. The Framework states explicitly that “non-legally binding obligations” differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent action to enforce settlement. The Framework describes the attributes of a non-legally binding obligations that give rise to liabilities as:
  - The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
  - As a result of such an indication the entity has created a valid expectation on the part of the those other parties that it will discharge those responsibilities; and
  - The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities

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<sup>1</sup> See paragraphs BC35 and BC87 of IFRS 15

It should be acknowledged that the drafting of the Framework somewhat clouds the issue.

## **REVENUE AND NON-EXCHANGE EXPENSES CONSULTATION PAPER DRAFT**

### **Chapter 1: Introduction**

- 1.1 The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. For decision-making and accountability purposes, users need information on the financial position, financial performance, and cash flows of an entity, as well as information on the:
- Provision of services to constituents;
  - Resources currently available for future expenditures, including restrictions or conditions attached to the use of those resources;
  - Burden on future tax-payers for current services; and
  - Changes in the entity's ability to provide services compared with the previous period.
- 1.2 The sources of funding for public sector entities include taxation, transfers from other public sector entities, and fees and charges. Public sector entities use these resources to provide services to the public in diverse ways.
- 1.3 The IPSASB has developed a number of International Public Sector Accounting Standards (IPSASs) that address the particular characteristics of public sector entities and their transactions. Through its ongoing work program the IPSASB aims to improve its standards and to develop requirements and guidance on topics not currently addressed by IPSASs. This Consultation Paper seeks feedback on possible improvements to accounting for revenue and potential requirements and guidance for accounting for non-exchange expenses.

### **Drivers for the projects on Revenue and Non-Exchange Expenses**

- 1.4 The IPSASB initiated the projects for which this Consultation Paper is an intermediate output in order to address the following areas where there is a public interest deficit:
- The gap in the current IPSASB literature on Non-Exchange Expenses;
  - Implementation issues with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*; and
  - Convergence with International Accounting Standards Board (IASB) literature, which has diminished with the publication of IFRS 15, *Revenue from Contracts with Customers*.

In addition the project assesses the alignment of the identified approaches with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

#### *Gap in the current IPSASB Literature on Non-Exchange Expenses*

- 1.5 Currently, IPSASB distinguishes exchange transactions and non-exchange transactions. This distinction is embedded in IPSASB's literature – for example *the Preface to the Conceptual Framework* notes that although non-exchange transactions are not limited to the public sector they

are far more common and financially material than in the private sector and therefore a key characteristic of the public sector. The current definitions of exchange and non-exchange transactions are provided in Chapter 2.

- 1.6 While a number of IPSASs provide guidance on the recognition of exchange expenses and liabilities, there is very little guidance on the recognition of expenses and liabilities arising from non-exchange transactions, and no equivalent to IPSAS 23, *Revenue from Non-Exchange Transactions (taxes and Transfers)* that deals with non-exchange expenses. The IPSASB has a current project to develop requirements and guidance for social benefits provided by public sector entities. The IPSASB issued a Consultation Paper, *Recognition and Measurement of Social Benefits*, in July 2015 and is currently considering the responses. An Exposure Draft of an IPSAS on Social Benefits will be issued in 2017. While this will be a major development an IPSAS on Social Benefits will only partially fill the 'gap' on non-exchange expenses.
- 1.7 Issued in October 2002, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, was drawn from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. IPSAS 19 can be used as a source of guidance for the recognition of provisions for non-exchange expense transactions ND has been used to develop accounting policies more broadly for non-exchange expenses. However, it was not developed for non-exchange transactions. This is reflected in the fact that, although IPSAS 19 does not have a blanket exclusion of all non-exchange expenses from its scope it explicitly excludes social benefits provided in non-exchange transactions. In addition, IPSAS 19 only deals with provisions – that is liabilities of uncertain timing and amount – rather than with liabilities and expenses more broadly. In dealing with non-exchange expenses IPSAS 19 therefore has a number of limitations.

#### *IPSAS 23 Implementation Issues*

- 1.8 IPSAS 23 was issued in December 2006, for application in annual financial statements covering periods beginning on or after June 30th, 2008. Preparers have identified a number of practical implementation issues, in particular:
  - Time requirements related to:
    - Multi-year financing
    - Taxation, received in advance of the period in which it is intended to be used
  - Stipulations (and the distinction between conditions and restrictions)
  - Capital grants
- 1.9 As its title suggests, IPSAS 23 requires preparers to classify transactions as exchange or non-exchange. While preparers have not expressed fundamental disagreement with the distinction between exchange and non-exchange transactions that underpins IPSAS 23, they have indicated that there are practical difficulties in making this classification. They have also questioned whether the separate presentation of information about exchange and non-exchange transactions provides useful information. Details of the results of interviews undertaken with preparers are included in Appendix A and are referenced throughout the Consultation Paper. Chapter 4 discusses the classification of expense transactions as exchange or non-exchange.

### *Convergence with IASB literature following the issue of IFRS 15*

- 1.10 In May 2014 the International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*. IFRS 15 replaces IAS 18, *Revenue* and IAS 11, *Construction Contracts*. IFRS 15 also replaces a number of interpretations<sup>1</sup>. IPSASB's current standards—IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts*—are based on IAS 18 and IAS 11. Therefore the replacement of these standards by IFRS 15 has reduced convergence between the IPSASB's and IASB's literature.
- 1.11 The core principle of IFRS 15 is that entities recognize revenue for the amount of consideration due to an entity in exchange for the goods and services provided to the customer. Revenue recognized reflects the transfer of control of the asset to the customer. The amount of revenue recognized is equal to the consideration the entity is entitled to for satisfying the performance obligation. This performance obligation approach represents new thinking on the recognition of exchange revenue. This new thinking also provides the opportunity to re-evaluate IPSASB's requirements and guidance for non-exchange revenue transactions.

### **Scope and Interaction with Other Projects and Pronouncements**

- 1.12 The revenue transactions within the scope of this Consultation Paper are those currently in the scope of IPSAS 9, IPSAS 11 and IPSAS 23 with one exception. Revenue that arises from the use by others of entity assets yielding interest, royalties, and dividends or similar distributions currently within the scope of IPSAS 9 is outside the scope of this Consultation Paper. Such transactions are being considered in the separate project to update IPSASB's standards on financial instruments—IPSAS 28, *Financial Instruments: Presentation*; IPSAS 29, *Financial Instruments: Recognition and Measurement*; and IPSAS 30, *Financial Instruments: Disclosure*.
- 1.13 Expense transactions that are within the scope of existing IPSASs are outside the scope of this Consultation Paper. For example, transactions related to employee benefits are within the scope of IPSAS 25, *Employee Benefits*.
- 1.14 Transactions that are in the scope of the IPSASB's Social Benefits project are not included in the scope of this Consultation Paper. Transactions that are in the scope of the current IPSASB projects on leases, public sector financial instruments, financial instruments, and public sector combinations are also outside the scope of this Consultation Paper.

### **Consultation Paper Structure**

- 1.15 The Consultation Paper covers both revenue and non-exchange expenses because the approaches outlined and evaluated that is the refined exchange/non-exchange approach and the public sector performance obligation approach— are equally applicable to revenue and expense transactions. Therefore, the IPSASB decided that, the development of separate Consultation Papers would include the duplication of a considerable amount of material and that such duplication would be unhelpful to readers. Considering both revenue and non-exchange expense transactions also facilitates an evaluation of the extent to which the options lead to consistent accounting approaches for accounting for revenue and non-exchange expenses.

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<sup>1</sup> These interpretations are SIC 31, *Revenue: Barter Transactions Involving Advertising Services*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for Construction of Real Estate*, and IFRIC 18, *Transfers of Assets from Customers*

- 1.16 Chapter 2 outlines the current approaches to revenue recognition in IPSASB's own literature (IPSAS 23, IPSAS 9 and IPSAS 11) as well as the new revenue recognition model in IFRS 15. Chapter 2
- 1.17 Chapter 3 considers how refined versions of the approaches outlined in Chapter 2 can be applied to non-exchange revenue transactions.
- 1.18 Chapter 4 considers the types of transactions encompassed by non-exchange expenses. It evaluates, the extent to which accounting requirements could be based on the requirements in IPSAS 19, or whether new guidance, analogous to the revenue recognition approach derived from IFRS 15 or the revenue recognition approach in IPSAS 23, should be developed.
- 1.19 Chapter 5 considers measurement of the transactions and other issues related to what have been termed non-contractual or statutory receivables and non-contractual or statutory payables.
- 1.20 The Consultation Paper does not consider requirements and guidance related to presentation. The IPSASB will consider presentation if and when the component projects reach the Exposure Draft stage.

## **REVENUE AND NON-EXCHANGE EXPENSES CONSULTATION PAPER DRAFT**

### **Chapter 2: Current Revenue Recognition Standards**

#### **Introduction**

- 2.1 This Chapter summarizes current approaches to revenue recognition in the literature of the IPSASB and the IASB. The chapter contrasts the exchange/non-exchange approach which underpins IPSAS 9, IPSAS 11 and IPSAS 23 and the performance obligation approach that is reflected in IFRS 15. The Chapter then introduces a classification scheme for public sector transactions based on whether such transactions include performance obligations. This is to inform further analysis, in particular the extent to which performance obligation approaches can be applied to public sector transactions.

#### **IPSASB Literature**

##### **Definitions**

- 2.2 Currently, the definitions of exchange and non-exchange transactions in the IPSASB's literature are:

##### Exchange transactions

Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

##### Non-exchange transactions

Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

#### ***Non-Exchange Transactions***

##### ***IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers)***

- 2.3 Issued in December 2006, IPSAS 23 prescribes requirements for the financial reporting of revenue from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. It includes high level and separate guidance on revenue recognition for taxes and transfers, the two most significant sources of non-exchange revenue for many governments and other public sector entities. For taxes IPSAS 23 defines the taxable event as the "event that the government, legislature, or other authority, has determined will be subject to taxation." The taxable event is the point at which an asset in respect of taxes is recognized and recognition criteria are met. IPSAS 23 provides high level guidance on the taxable event for a number of types of tax<sup>1</sup>, noting that it is essential for preparers to analyse the taxation law in their jurisdictions to determine the taxable event. IPSAS 23 acknowledges the following examples of transfers – grants, debt forgiveness, fines, bequests, gifts, donations and goods and services in-kind – and provides commentary on each.

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<sup>1</sup> Income tax, value-added tax, good and services tax, customs duty, death duty and property tax.

- 2.4 As its title suggests the primary determinant of whether a revenue transaction is within the scope of IPSAS 23 is whether it is exchange or non-exchange in character. IPSAS 23 acknowledges that there might be transactions that have an exchange or non-exchange component, and groups of transactions that are a combination of exchange and non-exchange transactions. IPSAS 23 uses an illustrative example of funding from a multi-lateral development agency that includes a grant and a concessionary loan with market and off-market components. Accounting for the exchange component of a transaction, or exchange transactions within a broader group of transactions, will be in accordance with another IPSAS. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.
- 2.5 IPSAS 23 states that an inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the transaction. Therefore, under IPSAS 23, an entity first determines whether an asset should be recognized, based on the inflow meeting the asset definition and recognition criteria. The entity then determines whether there are any liabilities related to the transaction.
- 2.6 In determining whether a transaction, or group of transactions, gives rise to liabilities IPSAS 23's definition of stipulations on transferred assets (hereafter stipulations), and the sub-categorization of stipulations into restrictions on transferred assets (hereafter restrictions) and conditions on transferred assets (hereafter conditions), is central. IPSAS 23 defines stipulations as "terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity".
- 2.7 Conditions require that the entity return the resources to the transferor if the condition is breached. Therefore, when a recipient of resources initially recognizes an asset that is subject to a condition, the recipient incurs a present obligation to transfer economic benefits or service potential to third parties. In such circumstances the recipient also recognizes a liability. The revenue recognized for such a transaction is the net amount of the asset and liability. As the entity satisfies the conditions related to the inflow of resources it reduces the carrying amount of the liability and recognizes revenue equal to the amount of the reduction.
- 2.8 Restrictions are defined as stipulations that limit or direct the purposes for which a transferred asset may be used. Restrictions do not specify that resources have to be returned to the transferor if they are not used as specified. Consequently, a recipient of resources with restrictions, but no conditions, does not recognize a liability and recognizes revenue as the gross amount of the inflow of resources. IPSAS 23 acknowledges that where there are breaches of restrictions, the transferor, or another party, may have the option of seeking a penalty against the recipient by legal or administrative processes. Such actions may result in a direction that the entity fulfill the restriction of face a civil or criminal penalty for defying the court, other tribunal or authority. However, IPSAS 23 explains that any such penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.
- 2.9 IPSAS 23 includes the following measurement requirements:
- An asset acquired through a non-exchange transaction is initially measured at fair value at the date of its acquisition;
  - A liability related to a condition(s) on a transferred asset is measured at the best estimate of the amount acquired to settle the present obligation at the reporting date; and
  - Revenue from non-exchange transactions is measured at the amount of the net increase in net assets recognized by the entity.



- 2.10 IPSAS 23 does not provide requirements or guidance on measurement subsequent to initial recognition. Chapter 5 of this CP discusses subsequent measurement and also considers measurement at initial recognition in more detail

### **Exchange Transactions**

#### **IPSAS 9, Revenue from Exchange Transactions**

- 2.11 IPSAS 9, *Revenue from Exchange Transactions*, was issued in July 2001. IPSAS 9 provides specific requirements and guidance on the recognition of revenue from the sale of goods, rendering of services, and the use by others of entity assets yielding interest, royalties, and dividends or similar distributions. Recognition of revenue is based on the following principles:

- **Rendering of services:** stage of completion.
- **Sale of goods and services:** the risk and rewards of ownership of the goods.
- **Interest:** a time proportion basis taking into account the effective yield on the asset.
- **Royalties:** as earned in accordance with the substance of the relevant agreement.
- **Dividends or similar distributions;** when the shareholder's or entity's right to receive payment is established.

- 2.12 Revenue is measured at the fair value of the consideration received or receivable.

- 2.13 IPSAS 9 is primarily drawn from IAS 18, *Revenue*. While there are differences of terminology and some additional commentary in IPSAS 9, the only significant substantive difference is that the definition of revenue adopted in IPSAS 9 does not include a reference to ordinary activities—this reflects a view that it is not straightforward to determine what an ordinary activity is in the public sector. The accounting treatments in the two standards are the same. IAS 18 will be replaced by IFRS 15 for accounting periods after January 1st 2018.

#### **IPSAS 11, Construction Contracts**

- 2.14 IPSAS 11, *Construction Contracts*, was also issued in July 2001. IPSAS 11 prescribes the accounting treatment of costs and revenue associated with construction contracts in the financial statements of the contractor.

- 2.15 IPSAS 11 provides a definition of construction contracts and requirements and guidance on the allocation of contract revenue and contract costs to accounting periods in which construction work is performed. Recognition of contract revenue and expense is based on the “stage or percentage of completion” approach when the outcome of the construction contract can be estimated reliably. If such an outcome cannot be estimated reliably, revenue is recognized only to the extent of recoverable contract costs.

- 2.16 IPSAS 11 was primarily drawn from IAS 11, *Construction Contracts*. In addition to differences of terminology, IPSAS 11 includes modifications to reflect the fact that, in the public sector, construction contracts may be on a non-commercial basis. For example, the IAS 11 definition of a “cost plus contract” is modified to include “cost-based contracts”, with no profit margin. Implementation guidance explains how the cost of completion approach is applied to non-commercial contracts. IPSAS 11 also acknowledged that arrangements can involve three parties with the third party providing funding and that, where funding in excess of that specified in the construction contract will be provided from an appropriation or other third party source, it is not necessary to recognize an expected deficit as an immediate expense. IAS 11 will be replaced by IFRS 15 for accounting periods after January 1, 2018.

## IASB Literature

### **IFRS 15, Revenue from Contracts with Customers,**

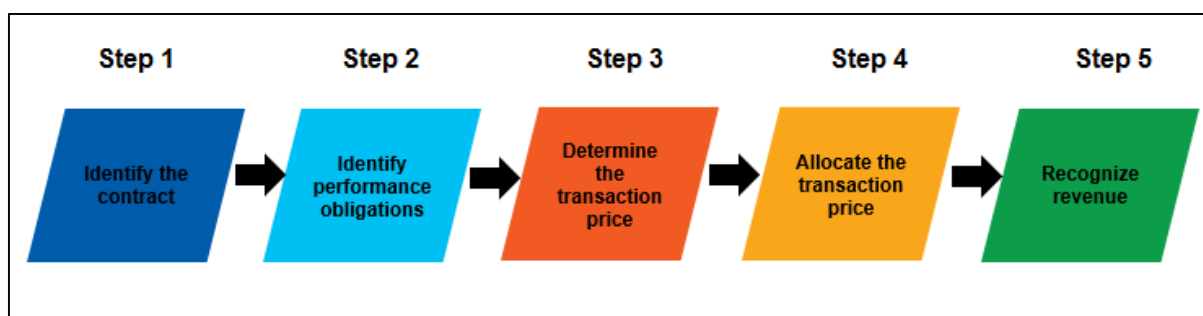
- 2.17 IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014. In September 2015 the IASB deferred the effective date by a year to January 1, 2018. In April 2016 the IASB issued *Clarifications to IFRS 15, Revenue from Contracts with Customers*, which provided clarifying amendments and some transitional reliefs. These clarifying amendments did not modify the principles underlying IFRS 15.
- 2.18 The core principles of the IFRS 15 performance obligation approach are:
- Revenue should be recognized to reflect the transfer of control of promised goods or services (performance obligations) to the customer; and
  - The amount of revenue recognized should be equal to the consideration that the entity is entitled to for satisfying those performance obligations.
- 2.19 Under IFRS 15 an entity recognizes revenue when (or as) it satisfies performance obligations. The timing of payment does not generally affect the recognition of revenue. Revenue recognition can occur before or after the entity receives payment, or is entitled to payment. If an entity satisfies the performance obligation before it is entitled to payment it recognizes a contract asset. When the entity becomes entitled to payment, it recognizes a receivable.
- 2.20 An underlying principle of the revenue recognition model in IFRS 15 is that revenue is not recognized until control of the promised goods or services is transferred to the customer. The concept of transferring control in a revenue transaction is more easily envisaged for the sale of goods (described as transferring control of assets). However, the performance obligation approach treats both goods and services as assets (even if only temporarily). Control of services rendered are transferred to the customer when the customer obtains the benefits of those services or the ability to direct the use of those benefits.
- 2.21 Under the IFRS 15 performance obligation approach, performance obligations may be satisfied:
- Over time (typically for promises to transfer services to a customer); or
  - At a point in time (typically for promises to transfer goods to a customer).
- 2.22 IFRS 15 allows for the recognition of revenue over time, if one of the following criteria is met:
- The customer simultaneously receives and consumes the benefits provided as the performance obligations are performed;
  - The entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
  - The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right for performance completed to date.
- 2.23 For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.
- 2.24 If an entity does not satisfy the IFRS 15 criteria to recognize revenue over time, revenue is then recognized at a point in time. This can result in revenue not being recognized in a contract delivered over multiple-periods until the promised goods or services are fully completed and control has been transferred to the customer.

2.25 When performance obligations are satisfied at a point in time, an entity is required to form a judgement as to when control of the goods or services are transferred to the customer. The indicators in IFRS 15 for determining the transfer of control at a point in time include (but are not limited to):

- The entity has a present right to payment for the asset;
- The customer has legal title;
- The entity has transferred physical possession to the customer;
- The customer has significant risks and rewards of the ownership of the asset; or
- The customer has accepted the asset.

2.26 The core principles of the performance obligation approach are explained in a five-step revenue recognition model. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to the customer at the amount to which the entity expects to be entitled. The five-step revenue model is important, not simply to a converged version of IFRS 15, but also to the Public Sector Performance Obligation approach discussed in Chapter 3, for which it provides the principles. The model is presented diagrammatically below and then the five steps are discussed.

**Five-step revenue recognition model:**



- (a) **Step 1: Identify the contract with the customer**—a contract is an agreement between two or more parties that creates enforceable rights and obligations.

The scope of IFRS 15 is limited to contracts with customers when all of the following criteria are met:

- The parties to the contract have approved the contract and are committed to perform their respective duties;
- Rights to goods and services to be transferred and payment terms can be identified;
- The contract has commercial substance; and
- Collection of consideration is probable.

- (b) **Step 2: Identify the performance obligations in the contract**—these are promises in a contract to transfer goods or services to a customer that are *distinct*.

If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a good or service that is distinct.

- (c) **Step 3: Determine the transaction price**—the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of consideration, but it may sometimes include variable consideration (which requires estimation when highly probable) and non-cash consideration. Discounting for the time value of money may be required.
- (d) **Step 4: Allocate the transaction price to the performance obligations in the contract**—an entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. This step includes consideration of discounts and variable consideration.
- (e) **Step 5: Recognize revenue when (or as) the entity satisfies the performance obligation**—an entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

2.27 In summary, the main characteristics of a revenue transaction within the scope of IFRS 15 are:

- There has to be a customer who receives the benefits of delivered goods or services, described as the satisfaction of performance obligations;
- The performance obligations can be identified;
- The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined;
- The performance obligations are established through a legal contract, which creates enforceable rights and obligations between the parties;
- The contract has commercial substance;
- Control of the promised goods or services is transferred to the customer;
- The transaction price can be allocated to the performance obligations in the contract; and
- Revenue is recognized by reference to when (or as) control of the promised goods or services are transferred to the customer

2.28 Chapters 3 and 4, re-express the IFRS 15 Performance Obligation Approach to develop a performance obligation approach to a broader range of public sector transactions.

*Development of IPSAS standard-level guidance converged with IFRS 15*

### **Categorization Public sector Transactions in Context of Performance Obligations**

2.29 The IPSASB has categorized transactions as follows:

**Category A:** Revenue and expense transactions with no performance obligations. For example, general taxation receipts and inter-governmental transfers, such as non-specific and non-earmarked grants. Such grants may be provided to finance the ongoing activities of multi-functional entities rather than be linked to particular programs.

**Category B** Revenue and expense transactions that contain performance obligations, but those performance obligations do not have all the characteristics of a transaction within the scope of IFRS 15. This category includes both exchange and non-exchange transactions (as currently defined in IPSAS 9). Category B also includes transactions involving three parties – an entity that enters into an arrangement to provide funding (resource provider), to another entity in return for delivering goods and services (resource recipient) to a third party who receives the direct benefit of those goods or services (resource beneficiary).

An example of such a tripartite arrangement is a grant from a central government department to a local government health provider to deliver a vaccination program to the community. The grant does not cover the full cost of the vaccination program. The application of the Public Sector Performance Obligation Approach to this example is provided in Appendix D.

**Category C:** Revenue transactions that are within the scope of IFRS 15. This category includes exchange transactions involving the transfer of promised goods or services to customers as defined in IFRS 15. The key characteristic of a Category C transaction is a contract with a customer which establishes identifiable and enforceable performance obligations.

An example is the delivery of contracted professional services by a public sector entity to other public sector entities at market rates. The application of the Performance Obligation Approach to this example is provided in Appendix D.

- 2.30 These categories are used to analyze the suitability and advantages and disadvantages of the approaches identified in Chapter 3 for revenue transactions and in Chapter 4 for non-exchange expense transactions. It is accepted that the categories involve a simplification of the complexities of public sector transactions. The final section of this chapter makes some observations and proposals on Category A and Category C transactions. This enables Chapters 3 and 4 to focus primarily on Category B transactions

### **Approach to Category C Transactions**

- 2.31 The IPSASB has an objective of convergence with IASB Standards, where appropriate. Therefore, for revenue transactions in the public sector which are similar in nature and substance to for-profit revenue transactions, the IPSASB considers that the standards-level requirements and guidance of the IPSASB and IASB should be converged and provide the same outcomes. The IPSASB is of the view that the quality of accounting for transactions currently addressed in IPSAS 9 and IPSAS 11 will be enhanced. A converged approach is also more efficient for consolidation in jurisdictions where commercially-oriented public sector entities report on an IFRS-basis.
- 2.32 The development of standards-level requirements and guidance converged with IFRS 15, for the purpose of application to Category C transactions, will require modification to allow the approach to be applied to public sector transactions. The IPSASB considers the extent of the modifications will be generally limited to changes of terminology rather than substance. In developing an IPSAS based on IFRS 15 to deal with Category C transactions the IPSASB will apply *The Process for Modifying IASB Documents* (also known as the Rules of the Road).
- 2.33 Modifications in developing an IPSAS primarily drawn from IFRS 15 may include:
- Modifying the IFRS 15 definition of revenue to ensure consistency with IPSASB's Conceptual Framework definition, including the removal of references to "ordinary activities";

- Modifying the recognition requirements for expenses arising from construction contracts where there are third party funding arrangements such as those acknowledged in IPSAS 11;
- Guidance to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and ownership contributions; and
- That rights and obligation are not only established through legal contracts, but can also be established through equivalent enforceable binding arrangements.

#### **Preliminary View 1**

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

- (i) Involve the transfer of promised goods or services to customers as defined in IFRS 15; and
- (ii) Arise from a contract with a customer which establishes identifiable and enforceable performance obligations.

The development of an Exposure Draft of an IPSAS primarily drawn from IFRS 15 will be in accordance with *The Process for Modifying IASB Documents* (the Rules of the Road) and involve a full due process.

#### **Preliminary View 2**

Because Category A transactions do not contain performance obligations IPSASB considers that these transactions will need be addressed in either a revised IPSAS 23 or a standard incorporating IPSAS 23 principles

#### **Specific Matters for Comment 1**

Do you agree that it is appropriate for IPSAS standard-level requirements and guidance to be developed on an IFRS 15 convergence basis for revenue transactions, which are associated with an arrangement containing all characteristics of an IFRS 15 performance obligation approach?

Please explain the reasons why you agree or disagree.

#### **IPSASB Matter for Consideration 1**

Do you agree with the preliminary views expressed in this chapter?

## **REVENUE AND NON-EXCHANGE EXPENSES CONSULTATION PAPER DRAFT**

### **Chapter 3: Recognition Options for Public Sector Specific Revenue Transactions**

#### *Introduction*

3.1 This chapter of the CP discusses recognition options for Category B transactions – that is transactions that involve the satisfaction of performance obligations, but do not contain all the characteristics required by IFRS 15 and outlined in Chapter 2. The chapter then addresses implementation issues related to IPSAS 23. As noted previously, if the Public Sector Performance Obligation approach is adopted for Category B transactions, IPSAS 23 will provide requirements and guidance for Category A transactions that do not contain performance obligations. IPSAS 23 (or an IPSAS incorporating IPSAS 23 principles) will therefore continue to be an essential part of the IPSASB's literature.

#### *The Public Sector Performance Obligation Approach*

3.2 The performance obligation approach in IFRS 15 was developed for commercial transactions where goods and services are delivered to customers in order to generate profits. The development of a performance obligation approach in a public sector environment, gives rise to a number of challenges when applied to non-commercial transactions.

3.3 In a public sector revenue transaction, in contrast to a private sector for-profit transaction, there may be:

- Less detail on the specifications of the goods or services to be supplied;
- Three parties involved instead of one supplier and one customer. Entities may receive funding from one party to provide goods or services to another party—resource provider, resource recipient and resource beneficiary;
- Difficulties determining when there has been a transfer of control of good and services to another entity or individual; and
- More uncertainty about enforceability. This may be because the agreements do not take the form of a legal contract, there is less detail in the agreement in regards to enforcement mechanisms, or because the parties do not normally take legal action to enforce the agreement.

#### *Key characteristics of a transaction within the scope of a public sector performance obligation approach*

3.4 The IPSASB considers the IFRS 15 revenue recognition model is an appropriate reference point to explore the extent to which a performance obligation approach could be developed for public sector revenue transactions involving the satisfaction of performance obligations, which do not meet the criteria in IFRS 15.

3.5 This section of the CP identifies eight key characteristics that the IPSASB considers need to be met by the recipients of resources in order for a transaction to be capable of being addressed by the Public Sector Performance Obligation Approach. The characteristics are cross-referenced to the five-step IFRS 15 approach outlined in Chapter 2. The eight characteristics are:

- The transaction is defined as a revenue transaction involving the satisfaction of performance obligations (*Initial Consideration*);
- The performance obligations are established through legally-binding arrangements (*Step 1*);
- The arrangement requires the satisfaction of performance obligations, which benefits either:
  - The resource provider (party providing the consideration or funding) directly through the satisfaction of agreed performance obligations; or
  - The intended beneficiaries of the performance obligations, as specified by the resource provider (*Step 2*)
- The agreed performance obligations within an arrangement are enforceable (*Steps 1/2*);
- The agreed performance obligations within an arrangement are identifiable and specific (*Step 2*);
- The funding (or consideration) provided in exchange for the satisfaction of agreed performance obligations can be determined and allocated to each identifiable and specific performance obligation (*Steps 3 and 4*);
- The funding provided for in an arrangement in exchange for the satisfaction of performance obligations:
  - Has been determined by giving consideration to the nature, cost, value or volume of the promised performance obligations; and
  - Is conditional on the satisfaction of agreed performance obligations (*Step 4*); and
- Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligations (*Step 5*)

3.6 These characteristics are discussed further in the following sections. If these key characteristics are not met for a revenue transaction, the IPSASB considers the public sector performance obligation approach will not be an appropriate model for the recognition of revenue. In these circumstances revenue will be recognized in accordance with a revised IPSAS 23.

#### **IPSASB Matter for Consideration 2**

Should the eight characteristics be re-expressed so that the analysis mirrors the IFRS 15 Five Step approach in Chapter 2 or is cross-referencing sufficient?

*Re-expression of IFRS 15 performance obligation characteristics for the purpose of developing a public sector performance obligation approach*

- 3.7 The key characteristics of the IFRS 15 performance obligation approach have been considered below and have been re-expressed for the public sector. The IPSASB is seeking feedback on whether the re-expressions below are appropriate and will allow a performance obligation approach to be applied to a broader range of public sector revenue transactions.
- 3.8 For each characteristic considered below, a table is provided comparing the performance obligation approach under IFRS 15 to the re-expressed Public Sector Performance Obligation approach. The development of the Public Sector Performance Obligation approach is not an IFRS convergence project. The comparison tables have been provided to illustrate the extent to which



the IFRS 15 characteristics could be expressed to better reflect the nature and substance of non-IFRS 15 related public sector transactions with performance obligations.

(a) The transaction is defined as a revenue transaction involving the satisfaction of performance obligations

3.9 The scope of IFRS 15 is limited to *revenue* transactions, defined as “*income arising in the course of entity’s ordinary activities*”. The current IPSASB literature does not generally make a distinction between ordinary activities and activities outside the ordinary course of operations. The reason for this was primarily because of the multi-functional nature of many public sector entities.

3.10 The IASB uses the term income as an overall term and revenue as a subset of income. The definitions of income and revenue as provided for in IFRS 15 Appendix A, reflect this distinction.

*Revenue: Income arising in the course of an entity’s ordinary activities.*

*Income: Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.*

3.11 The IPSASB’s Conceptual Framework does not distinguish between ordinary activities and activities outside the ordinary course of activities, although it does not preclude such a distinction at standards level. The Framework defines revenue as:

*Increases in the net financial position of the entity, other than increases arising from ownership contributions.*

3.12 Public sector entities are often engaged in a wide variety of activities and therefore the IPSASB considers it appropriate to remove any reference to “ordinary activities” from a public sector performance obligation approach. The re-expression of the definition of revenue from that used in IFRS 15, will allow the approach to be extended to a broader range of public sector transactions.

3.13 When developing standard-level requirements for revenue transactions under a performance obligation approach, guidance will be provided to assist users to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and inflows related to ownership contributions.

<b>Performance Obligation Approach Characteristic (a)</b>	
The transaction is defined as a revenue transaction involving the satisfaction of performance obligations	
<b>IFRS 15 Performance Obligation Approach</b>	<b>Public Sector Performance Obligation Approach</b>
The scope includes only <i>revenue</i> transactions.  Revenue: Income arising in the course of an entity’s ordinary <i>activities</i>	The scope includes revenue transactions as defined by the IPSASB’s Conceptual Framework:  Revenue: Increases in the net financial position of the entity, other than increases arising from ownership contributions.  The approach will be amended to remove any references to ordinary activities.

	<p>Additional guidance provided to distinguish between revenue transactions and ownership contributions.</p> <p>The scope of the approach will include revenue transactions arising from the satisfaction of performance obligations and will not include other gains arising from the disposal of assets or the recognition of asset fair value movements for example.</p>
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(b) The performance obligations are established through legal and equivalent binding arrangements

3.14 The scope of the IFRS 15 performance obligation approach does not include all revenue transactions. It only applies to revenue arrangements where the associated rights and obligations are established by legally enforceable contracts with customers. IPSASB's literature typically refers to binding arrangements rather than legal contracts because, in some jurisdictions, public sector entities do not have the legal authority to enter into contracts.

3.15 The IPSASB considers it appropriate that the scope of the performance obligation approach, which focuses on contracts with customers, be re-expressed to include revenue transactions with performance obligations established through enforceable legislation and other legal and equivalent binding arrangements that give rise to liabilities. The IPSASB's Conceptual Framework includes both legal and non-legally binding arrangements when discussing the concept of a present obligation for the purpose of defining a liability.

### **IPSASB Matter for Consideration 3**

The Conceptual Framework uses the phrases "legal" and "non-legally binding obligations". While that terminology is not at all helpful the Framework is clear that non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement". The issue is should the public sector performance obligation approach apply to non-legally binding obligations?

3.16 To extend the performance obligation approach to broader range of public sector transactions, the IPSASB considers it appropriate to re-express the scope to include performance obligations, where those performance obligations are established through legislation or regulation.

3.17 When identifying a contract, IFRS 15 assumes the customer when entering into a contract has an ability and intention to pay the consideration when due. This cannot be always assumed in the public sector and additional guidance may be needed. Additional guidance is required for arrangements where the activities associated with the delivery of performance obligations commences before funding amounts have been confirmed.

[TBG: Not fully convinced that this section is needed and, if it is, whether it needs to be this long. The key issue is enforceability which is dealt with below.]

<b>Performance Obligation Approach Characteristic (b)</b>	
The performance obligations are established through legal (or equivalent) binding arrangements	
<b>IFRS 15 Performance Obligation Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>IFRS 15 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations.</p> <p>IFRS 15.9 further defines the characteristics of a contract within scope:</p> <ul style="list-style-type: none"> <li>• The parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practice) and are committed to perform their respective obligations;</li> <li>• The entity can identify each party's rights and obligations regarding the goods and services to be transferred;</li> <li>• The entity can identify the payment terms for the goods or services to be transferred;</li> <li>• The contract has commercial substance; and</li> <li>• It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.</li> </ul>	<p>The rights and obligations in a transaction involving the satisfaction of performance obligations, which are identifiable and enforceable, are established by an agreement between two or more parties.</p> <p>The agreement could take the form of a legal or equivalent binding arrangement (as defined in the IPSASB's Conceptual Framework)</p> <p>The intention is to include within the scope a broader range of enforceable arrangements that establish rights and obligations that meet the IPSASB Conceptual Framework definition of a liability.</p> <p>A key criterion of an agreement within scope is whether the agreement is enforceable by another party and performance obligations are identifiable and specific. Both the concepts of enforceability and identifiability, are discussed further below.</p> <p>Additional guidance will be provided for arrangements where the activities associated with the delivery of performance obligations commences before funding amounts have been confirmed or where it is not probable that funding will be received.</p> <p>[TBG: Is this a standards-level consideration?]</p>

- (c) The arrangement requires the satisfaction of performance obligations, which benefits either the resource provider or resource beneficiary

*IFRS 15 characteristic*

3.18 IFRS 15 requires the identification of the customer in each contractual arrangement. This is a key feature, because the performance obligation is built on the principle that revenue is not recognized until control of promised goods or services is transferred to the customer.

*Performance obligation characteristic re-expressed for the public sector*

3.19 The nature of revenue transactions in the public sector often precludes the identification of a specific customer. The goods and services provided by public sector entities are often determined by their legislative mandate and provided to a wide range of people and entities. These goods and services are also often provided collectively rather than individually. Specific direct recipients

of these goods and services and the portion of the service provided to individual recipients cannot always be identified, for example defense and policing services.

- 3.20 Public sector transactions often involve three parties– the resource provider who provides the consideration, the resource recipient who receives the consideration and is responsible for the delivery of specific goods or services, and the resource beneficiary of those goods or services, which can include individuals or the wider public. The resource provider in the public sector will often not receive the direct benefit of the performance obligation in exchange for agreed consideration (funding). However, in the public sector the resource provider is often viewed as receiving the benefits of satisfied performance obligations delivered to third parties (beneficiaries). This is because the resource provider has the ability to direct who receives the benefits of those performance obligations and provision of the benefits is in accordance with the resource provider’s objectives.
- 3.21 The IPSASB considers that the performance obligation approach will be appropriate for arrangements involving three parties (resource provider, resource recipient, and resource beneficiary) when:
- Performance obligations have been clearly specified; and
  - The intended beneficiaries of those performance obligations have been clearly specified even though individual beneficiaries may not be identified.

<b>Performance Obligation Approach Characteristic (c)</b>	
The agreement requires the satisfaction of performance obligations, which benefits either the resource provider or the intended beneficiaries as specified by the resource provider.	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
The contractual arrangement requires the delivery of goods or services to a customer.  A customer is defined as a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.	The arrangement requires the satisfaction of performance obligations, which either benefit the: <ul style="list-style-type: none"> <li>• Resource provider (funder) directly through the delivery of goods or services; or</li> <li>• Intended beneficiaries of agreed performance obligations, as specified by the resource provider.</li> </ul>

- (d) The agreed performance obligations in the arrangement are enforceable

*IFRS 15 characteristic*

[TBG: I have drafted this section to exclude what the Conceptual Framework calls “non-legally binding obligations”. See above]

- 3.22 A key characteristic of the IFRS 15 performance obligation approach is that performance obligations in contracts are enforceable through commercial law in each jurisdiction.
- 3.23 The IFRS 15 performance obligation approach is only appropriate for agreements between two or more parties that create enforceable rights and obligations.

- 3.24 IFRS 15, paragraph 10 provides guidance on when rights and obligations in an agreement are enforceable:

*A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.*

*Performance obligation characteristic re-expressed for the public sector*

- 3.25 The IPSASB considers that enforceability should be reflected in a public sector performance obligation approach. A key principle underpinning the performance obligation approach is the recognition of a liability when consideration (funding) has been received, but associated promised performance obligations have not yet been delivered. Under a public sector performance obligation approach agreements will only be within scope when they are enforceable. Additional guidance will be needed to determine when an arrangement will be defined as enforceable.

- 3.26 To extend the performance obligation approach to a broader range of public sector transactions, the IPSASB considers it appropriate that the definition of enforceability be extended to include rights and obligations established through "legal or equivalent means", rather than be limited to the enforcement of contracts through commercial law.

- 3.27 For constructive obligations to be enforceable by "equivalent means" requires the presence of mechanisms outside the legal system that establish an external party's right to call upon an entity to act in a particular way thereby leaving that entity with little, if any, discretion to avoid settling a performance obligation. There are a variety of mechanisms in which public sector entities can enforce performance obligations in agreements with other parties. These depend on the legal system in place in a jurisdiction and the types of agreements the public sector entities can enter into.

- 3.28 The enforcement of agreed performance obligations in the public sector can include using the:

- Remedies set out in the binding agreement (for example, penalties for late delivery or non-performance);
- Remedies available under contract law and consumer protection law that applies to public sector entities (for example, the right and ability to demand return of funding for non-performance);
- Negative impact on an entity's reputation from non-performance (for example, public disclosure of non-performance); and
- Ability to make an entity aware that, if it does not meet its obligations under a revenue arrangement, it risks not having a future funding relationship.
- [TBG: This is a question for Board. However, should prefer to delete. Something that has a negative impact on an entity's reputation may give rise to a non-legally binding obligation (constructive obligation), but it doesn't give rise to an enforceable obligation. Same applies for maintenance of a funding relationship]

Additional guidance will be required to clarify the types of legal and equivalent mechanisms considered appropriate for a public sector performance obligation approach.

3.29 In summary, the concept of enforceability under a public sector performance obligation approach will be established through legal or equivalent means. The interpretation of enforceability will require judgement when compared to IFRS 15, which takes a purely legal approach to defining enforceability. Ultimately for each revenue arrangement an entity will need to consider if performance obligations are enforceable, based on an assessment of whether an agreed performance obligation establishes a present obligation, which an entity has little or no realistic alternative to avoid.

<b>Performance obligation approach characteristic (d)</b>	
<b>The agreed performance obligations in the arrangement are enforceable</b>	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practice, published policies or specific statements.</p>	<p>Enforceability of rights and obligations in an arrangement are established through legal or equivalent means (i.e. legal and non-legally binding arrangements). An agreement is enforceable by another party through legal or equivalent means if:</p> <ul style="list-style-type: none"> <li>• The resource provider providing the consideration (funding), has through an agreement established the right to enforce specific performance obligations; or</li> <li>• A mechanism exists to provide the resource provider with legal authority to require the entity to either satisfy the performance obligation or compensate it for not satisfying agreed performance obligations; or</li> <li>• A mechanism outside the legal system that establishes the right of a separate party to require the entity to act in a particular way or be subject to consequences.</li> </ul> <p>Defining arrangements where the resource provider has the ability to enforce the satisfaction of agreed performance obligations will require an assessment of the resource provider's past business practices. For example; when funding is provided in exchange for the satisfaction of performance obligations and those performance obligations are not satisfied, can the resource provider demonstrate a past practice of enforcing the return of funding or imposing other forms of penalties?</p>

(e) The agreed performance obligations within an arrangement are identifiable and specific

*IFRS 15 characteristic*

- 3.30 IFRS 15 provides that a performance obligation approach is only appropriate when, a contract explicitly states the goods or services an entity has promised to transfer to a customer. Performance obligations can only be enforced when each party has agreed to the promised goods or services to be delivered.
- 3.31 IFRS 15 requires the identification of performance obligations, to enable the determination of when a performance obligation has been satisfied. A performance obligation is defined as a good or service in a contract with a customer that is “distinct”. If a promised good or service within the agreement is not distinct it is combined with other promised goods or services until a bundle of goods or services is identified that are distinct.
- 3.32 The objective of identifying each distinct performance obligation within a contract with a customer is to determine whether an entity’s promise to transfer that good or service is separately identifiable from other promises in the contract, and should therefore be accounted for separately.

*Performance obligation characteristic re-expressed for the public sector*

- 3.33 The IPSASB considers a public sector performance obligation approach will be appropriate for arrangement that allow for each specific performance obligation to be identified. Under a public sector performance obligation approach, the IFRS 15 description of “distinct goods or services” could be replaced with “specific and identifiable performance obligations”. The change in terminology reflects the view that the preciseness of promises to transfer goods or services in a for-profit context under IFRS 15, can be quite different than the agreed satisfaction of agreed performance obligations in the public sector.
- 3.34 Determining when a performance obligation is specific and identifiable will often require a greater level of judgement in the public sector, in comparison to private sector for-profit transactions. Appendix D of the CP presents the example of a central government providing a grant to a local government health provider to support the provision of dental services. The arrangement does not clearly specify the goods or services to be purchased or delivered. In this scenario the IPSASB considers a public sector performance obligation approach could be appropriate, when the performance obligations are identifiable and specific.
- 3.35 In the example above, a key indicator of whether there are separate performance obligations in the arrangement which are identifiable, is whether the resource recipient (entity receiving funding and accepts responsibility for satisfaction of performance obligations) can demonstrate the satisfaction of separate performance obligations within the arrangement. The resource recipient could demonstrate satisfaction of performance obligations, by providing evidence of the costs incurred delivering dental services to the public.
- 3.36 In contrast, when for example a central government provides funding to another public sector entity to support the continuance of general operations, a public sector performance obligation approach will not be appropriate due to there being no specific performance obligations or restrictions over the use of funds. In substance, there are no separate or identifiable specific performance obligations within the arrangement, because all funding provided could be spent immediately or deferred to support future operating costs.
- 3.37 Under a public sector performance obligation approach, if the performance obligations within an arrangement are not specific and identifiable, the resource recipient will be required to combine agreed performance obligations until it has identified a bundle of performance obligations that are

specific and identifiable. Additional guidance on determining when a performance obligation is identifiable and specific is provided in the summary table below.

- 3.38 The identification of separate performance obligations in an arrangement directly impacts when revenue is recognized. Under a performance obligation approach revenue is generally not recognized until the separate performance obligation has been satisfied, therefore the bundling of agreed performance obligations will often result in a deferral of revenue recognition.

<b>Performance obligation approach characteristic ( e )</b>	
The agreed performance obligations within an arrangement are identifiable and specific	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>To qualify as a performance obligation, the entity's promise to transfer goods or services in a contract with a customer must be <i>distinct</i>.</p> <p>A good or service that is promised to a customer is distinct if both the following criteria are met:</p> <ul style="list-style-type: none"> <li>• The customer can benefit from the good or service on its own or together with other resources that are readily available; and</li> <li>• The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.</li> </ul> <p>If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identified a bundle of goods or services that is distinct.</p>	<p>To qualify as a performance obligation, an entity's promise to satisfy agreed performance obligations in an enforceable arrangement with a resource provider must be identifiable and specific.</p> <p>The agreement must provide specific information regarding the nature, cost, value or volume of the agreed performance obligations that allow for each performance obligations to be separately identifiable.</p> <p>A performance obligation will be defined as identifiable and specific when:</p> <ul style="list-style-type: none"> <li>• The performance obligation is separately identifiable from other performance obligations within the arrangement;</li> <li>• The resource recipient can determine when the performance obligation has been satisfied; and</li> <li>• The resource recipient can demonstrate to the resource provider the performance obligation has been satisfied.</li> </ul> <p>If the performance obligations within an arrangement are not specific and identifiable, the resource recipient will be required to combine agreed performance obligations until it has identified a bundle of performance obligations that are specific and identifiable.</p>



## Specific Matter for Comment 2

The CP considers a public performance obligation approach is only appropriate when agreed performance obligations within an arrangement are “identifiable and specific”.

The main criteria for determining when a performance obligation is identifiable and specific is whether the resource recipient has both the ability to determine when a separate performance obligation has been satisfied and an ability to demonstrate to the resource provider the performance obligation has been satisfied.

1. Do you agree with the use of the term identifiable and specific?
2. Do you agree with the criteria for determining when a performance obligation identifiable and specific (as indicated in the summary table)? The criteria too restrictive or additional guidance recommended?

If you think that the criteria are too restrictive or that additional guidance should be provided please provide suggestions for any amendments.

- (f) The funding provided for in the arrangement has been determined by giving consideration to the agreed performance obligations, and funding is conditional on the delivery of agreed performance obligations.

### *IFRS 15 characteristic*

3.39 The performance obligation approach within IFRS 15 has been developed for private sector for-profit transactions, where it is assumed that a contract with a customer to deliver promised goods or services has commercial substance. The reference to commercial substance within IFRS 15 is used to describe two characteristics assumed in a contract to deliver promised goods or services to a customer:

- The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered; and
- The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services.

### *Performance obligation characteristic re-expressed for the public sector*

3.40 Both of these characteristics, which are assumed in a private sector for-profit transaction, are not always applicable to public sector transactions involving the satisfaction of performance obligations. Therefore, the IPSASB has considered how these characteristics could be re-expressed for a public sector performance obligation approach.

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

3.41 The IPSASB considers it appropriate that the public sector performance obligation approach continues to be applicable to arrangements where the amount of funding is determined by the resource provider giving consideration to the level of agreed goods and services to be delivered. Under the public sector performance obligation approach, this characteristic could be described as an arrangement where it can be demonstrated that the amount of funding provided has been determined by the resource provider (the funder) in relation to the nature, cost, value or volume of the agreed performance obligations. In general terms, to apply a public sector performance obligation approach, an entity will need to demonstrate a linkage between the amount of agreed funding and the satisfaction of performance obligations.

- 3.42 An indicator of whether a linkage between the amount of funding and performance obligations can be demonstrated, will be whether the arrangement provides for the amendment of funding levels when agreed performance obligations are not met or are exceeded.
- 3.43 Another indicator of a linkage between the amount of funding and the performance obligations, is where the amount of funding is conditional on the satisfaction of agreed performance obligations. If funding is unrelated to whether performance obligations are satisfied, the performance obligation approach will not be an appropriate revenue recognition model for these transactions.
- 3.44 Where there is no linkage between the funding and performance obligations, it would be difficult to demonstrate that performance obligations are enforceable, because there are effectively no financial consequences for non-performance. Under this scenario, the public sector performance obligation approach will not be an appropriate revenue recognition model.
- (ii) *The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services*
- 3.45 In the private sector it is assumed the amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services. This is because commercial arrangements are entered into by a willing buyer and a willing seller.
- 3.46 In public sector arrangements where performance obligations are expected to be delivered in exchange for funding received from another entity, it cannot be assumed that the amount of funding received will be approximately equal to the value of the agreed performance obligations.
- 3.47 Public sector entities often provide subsidized services, for example a swimming pool owned and operated by a local government entity will receive funding from central government to subsidize the cost of providing swimming facilities, which are not fully recovered by user fees. In these circumstances it can prove difficult to determine if each party providing funding to the local government entity is receiving services which are considered to be of approximately equal value to the funding (or entrance fees) exchanged.
- 3.48 Determining when a revenue transaction involves one entity receiving assets or services in exchange for funding of approximately equal value, is currently a concept within IPSAS 23, used when classifying transactions as either exchange or non-exchange. The exchange of approximately equal value between two or more parties may not be a characteristic of all public sector transactions involving the satisfaction of performance obligations. This is due to public sector transactions often occurring on non-market terms. Consequently determining when a transaction involves the exchange of approximately equal value requires a significant amount of judgement.
- [TBG Is paragraph 3.47 necessary? The whole point of the public sector performance obligation approach is that it gets away from the difficulties of the exchange/non-exchange distinction]
- 3.49 In developing the public sector performance obligation approach the IPSASB considered that the emphasis should be on the need for an arrangement to demonstrate that funding has been determined by giving consideration to the agreed performance obligations and demonstrating the funding is conditional on the satisfaction of the performance obligations.

<b>Performance obligation approach characteristic: (e)</b>	
The funding provided for in the arrangement has been determined by giving consideration to agreed performance obligations, and funding is conditional on the delivery of agreed performance obligations.	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The scope includes contracts which have commercial substance (i.e. the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract).</p>	<p>An arrangement within the scope, will be required to demonstrate a linkage between the funding provided to another entity and the agreed performance obligations.</p> <p>The scope of the public sector performance obligation approach is limited to arrangements where the amount of funding:</p> <ul style="list-style-type: none"> <li>○ Has been determined by giving consideration to the nature, cost, value or volume of the promised goods and services to be delivered; and</li> <li>○ Is conditional on the delivery of promised goods or services.</li> </ul>

- (g) The funding provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation

*IFRS 15 characteristic*

- 3.50 IFRS 15 defines the total amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer as the “transaction price”. The allocation of the transaction price to each performance obligation within a contract is a critical step in the revenue recognition model, because this step directly impacts how much revenue will be recognized when (or as) performance obligations are satisfied.
- 3.51 IFRS 15 requires the transaction price to be allocated to each performance obligation (each distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. The transaction price is allocated to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or service. If a stand-alone selling price is not observable, an entity is required to estimate it. IFRS 15 provides examples of methodologies an entity could choose to use to determine or estimate the stand-alone selling price.

*Performance obligation characteristic re-expressed for the public sector*

- 3.52 Within the public sector, goods and services do not always have stand-alone selling prices, due to the integrated nature of the goods and services provided. Many public sector entities do not compete directly with private sector entities and may not price goods or services based on market considerations. Many public sector entities receive funding in exchange for the satisfaction of performance obligations, which involve the delivery of goods or services to the public. For example; funding from the central government to other public sector entities to deliver education and health care services to the public. Under these arrangements it can prove difficult to

determine the stand-alone selling price of each identifiable and specific performance obligation within the funding arrangement.

- 3.53 Under the public sector performance obligation approach, the IPSASB considers it appropriate to place less emphasis on the need to determine the “stand-alone selling price” and instead focus on an entity’s ability to determine the “cost of delivery” for each identifiable and specific performance obligation, as a basis for allocating the total amount of agreed funding to each performance obligation.
- 3.54 If the allocation of the total amount of agreed funding to each identifiable and specific performance obligation cannot be estimated reliably on a cost of delivery basis, this would indicate that it may not be appropriate to account for the arrangement in accordance with the public sector performance obligation approach.

*Donation component*

- 3.55 When allocating the total amount of agreed funding (consideration) in an arrangement, under a public sector performance obligation approach, the first step required is the identification of any separately identifiable funding amounts not related to the satisfaction of agreed performance obligations.
- 3.56 The amount of agreed funding not attributable to the satisfaction of performance obligations within an arrangement should be accounted for separately, referred to as a donation component. If a revenue transaction includes an identifiable donation component this should be excluded from the funding balance allocated across the performance obligations, and recognized as revenue in accordance with the residual revenue guidance for Category A transactions.
- 3.57 The IPSASB considers the following indicators could be used to provide evidence that a component of the revenue funding is separately identifiable from the funding provided in exchange for satisfaction of performance obligations:
- The customer or resource provider makes the entity aware that there was intended to be a donation component in the arrangement;
  - The entity’s entitlement to retain the donation is not conditional on the satisfaction of performance obligations; and
  - The amount of the donation component allocated to the non-exchange component can be separately identified and measured reliably.
- 3.58 Where both the existence and amount of the donation component is unclear, then the entire amount of funding is included in the agreed funding balance allocated across performance obligations.

<b>Performance obligation approach characteristic (g)</b>	
The funding (or consideration) provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The entity shall allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.</p> <p>To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone basis.</p>	<p>The entity shall allocate the total amount of funding to each identifiable and specific performance obligation in an amount that depicts the amount of funding (consideration) to which the entity expects to be entitled in exchange for satisfaction of the performance obligation.</p> <p>To meet the allocation objective, an entity shall allocate the total amount of agreed funding to each identifiable and specific performance obligation identified in the arrangement on an estimated cost of delivery basis.</p> <p>The resource recipient will need to demonstrate it can estimate the cost of delivering each identifiable and specific performance reliably.</p> <p>If a revenue transaction includes an identifiable donation component this should be excluded from the total amount of funding allocated across performance obligations, and recognized as revenue in accordance with the residual revenue standard for Category C transactions.</p> <p>Where both the existence and amount of the donation component is unclear, the entire amount of funding is included in the agreed funding balance allocated across performance obligations.</p>

**Specific Matter for Comment 3**

Do you agree that the cost of delivery approach is the appropriate method for allocating the total amount of funding across identifiable and specific performance obligation?

If you think that there are alternative options please identify them and explain them

- (h) Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligation

*IFRS 15 characteristic*

3.59 Under the IFRS 15 revenue recognition model an entity satisfies performance obligations when (or as) the promised goods or services (described as assets) are transferred to the customer. An asset is transferred when (or as) the customer obtains control of that asset. Revenue is recognized when (or as) control of the promised goods or services are transferred to the customer.

*Performance obligation characteristic re-expressed for the public sector*

3.60 Public sector revenue transactions often include performance obligations in the form of a promises to complete certain activities to support the delivery of goods or services to the public (resource beneficiaries). In these transactions there is often no direct transfer of control of promised goods or services to the party providing the source of funding (resource provider) or to specific individuals in the public.

3.61 Under a public sector performance obligation approach, the IPSASB consider it appropriate to re-express the trigger for revenue recognition from when (or as) the entity “transfers control of a good or service” to when (or as) the resource recipient “satisfies the promised performance obligation”. Although IFRS 15 requires an assessment of when control of an asset is transferred to a customer, the underlying principle is the determination of when performance obligations have been satisfied.

3.62 The recognition of revenue as performance obligations are satisfied relies on the ability of the resource recipient (the entity which receives the funding and accepts responsibility for satisfaction of performance obligations) to demonstrate to the resource provider that it has satisfied a performance obligation. This principle is of particular importance in arrangements where the wider public receive the benefits of satisfied performance obligations, rather than the resource provider directly.

3.63 Demonstrating the satisfaction of performance obligations could be evidenced by reporting on progress to the resource provider. This might be a single progress report (for a performance obligation satisfied at a point in time) or a series of progress reports (for a performance obligation satisfied over time). Reporting on performance obligation progress as a function on its own will not trigger the recognition of revenue, but will be used to provide appropriate evidence and support that identifiable and specific performance obligations have been satisfied.

3.64 Under a public sector performance obligation approach, the timing of cash flows between the resource provider and resource recipient will not affect the pattern of revenue recognition. Revenue will be recognized when (or as) performance obligations are satisfied. If consideration for the delivery of promised goods or services is received in advance of satisfying the performance obligation, then this will give rise to a liability of the resource recipient.

<b>Performance obligation approach characteristic (h)</b>	
Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligation	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
An entity recognizes revenue when (or as) it satisfies performance obligations, which is when control of the promised goods or services are transferred to the customer.	A resource recipient recognizes revenue when (or as) it satisfies each identifiable and specific performance obligation; this will occur when:

	<ul style="list-style-type: none"> <li>• The resource recipient has the ability to demonstrate to the resource provider the performance obligation has been satisfied; and</li> <li>• The resource recipient has the ability to demonstrate to the resource provider that the intended beneficiaries of the performance obligations have benefited from the delivered performance obligations.</li> </ul>
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**Specific Matter for Comment 4**

Do you agree that the trigger for revenue recognition in the Public Sector Performance Obligation approach) should be when the entity “satisfies the promised performance obligations”

If you disagree please indicate what should be the trigger for revenue recognition and indicate your reasons?

**Applying the Performance Obligation Approach to Common Public Sector Arrangements**

<b>Arrangements</b>	<b>Applicability</b>
One Year Specific Grant	Applicable if the following characteristics are present:  Arrangement is enforceable  Arrangement contains identifiable and specific performance obligations that must be fulfilled by recipient  Funding can be allocated to each of the performance obligations
Capital Grants	Applicable if the following characteristics are present:  Arrangement is enforceable  Arrangement contains identifiable and specific performance obligations that must be fulfilled by recipient  Funding can be allocated to each of the performance obligations
Multi-Year Research Grants	Applicable if the following characteristics are present:  Arrangement is enforceable

	<p>Arrangement contains identifiable and specific performance obligations that must be fulfilled by recipient</p> <p>Funding can be allocated to each of the performance obligations</p> <p>Not applicable if the research grant does not have clearly identified deliverables, whether to the resource provided or a resource beneficiary or of funding cannot be allocated to performance obligations</p>
General (non-specific grants)	Not applicable as such grants do not contain performance obligations. Account for under

**[Note to IPSASB: This Table needs to be supported by some fact patterns that will be developed for the December meeting and include as appendices]**

**The Exchange/Non-Exchange Approach: Revised IPSAS 23**

3.65 As its name indicates under the exchange versus non-exchange approach the current distinction between exchange and non-exchange transactions is retained as the primary determinant of accounting treatments. IPSAS 23 will therefore continue to provide requirements and guidance for revenue from non-exchange transactions regardless of whether such transactions contain performance obligations. The identification of performance obligations will be useful in distinguishing conditions and restrictions—as we have noted conditions reflect performance obligations. However, this is a secondary consideration following the initial decision whether a transaction is exchange or non-exchange. The retention of the Exchange/Non-Exchange approach will involve far less change.

**(a) Applying the Exchange/Non-Exchange Approach Public Sector Arrangements**

<b>Arrangements</b>	<b>Applicability</b>
<i>One Year Specific Grants</i>	Applicable. Accounting treatment dependent upon the existence of stipulations and whether those stipulations are conditions or restrictions.
<i>Capital Grants</i>	Applicable, although identifying stipulations in capital grants problematic
<i>Multi-Year Research Grants</i>	Applicable. Accounting treatment dependent upon the existence of stipulations and whether those stipulations are conditions or restrictions.
<i>General (non-specific grants)</i>	Not a Category B transaction. Would be dealt with under revised IPSAS 23 (or IPSAS incorporating IPSAS 23 principles).

**[Note to IPSASB: This Table needs to be supported by some fact patterns that will be developed for the December meeting and include as appendices]**



3.66 As Chapter 2 has emphasized if IPSAS 23 is retained – either in its current guise or in a revised role in which it provides requirements and guidance for transactions without performance obligations – it will be important to address certain implementation issues that have been identified by preparers. The following paragraphs therefore address these issues:

- Time requirements—government transfers received in advance of year for which intended; multi-year financing and any funding, particularly taxation, received in advance of the period in which it is intended to be used;
- Capital Grants
- Receipts in advance
- Services in kind

#### *Time Requirements*

3.67 The treatment of time requirements is probably the most controversial aspect of IPSAS 23. Currently time requirements are restrictions rather than conditions. Some preparers think that IPSAS 23 gives rise to accounting outcomes that do not present relevant and faithfully representative information or information that is understandable and promotes inter-entity comparisons. This is because IPSAS 23 requires the recipients of transferred resources to recognize both an asset and revenue unless an enforceable agreement contains conditions –that is to say there is both a performance obligation and a return obligation. Therefore resources transferred without conditions prior to the reporting period for which they are intended give rise to revenue at the point at which they are received and the recipient controls those resources.

3.68 The transactions that may be affected by this requirement include some of the most important resources that public sector entities receive to finance their activities—government transfers, taxation receipts and general multi-year grants. Consequently, unless there is a return obligation related to the resources if they are not used in a specified manner, government transfers and taxation receipts received in advance of the period for which they are intended and multi-year grant financing are recognized when they are received. The result is that, for example, the resources from a five-year grant without conditions are recognized as revenue in one reporting period.

#### Reclassifying time requirements as conditions

3.69 The most superficially straightforward solution to this issue is to reclassify time requirements as conditions. However, this would require a number of steps, which would create inconsistencies with IPSASB's broader literature – such as modifying the definition of a condition on a transferred asset, so that it specifically includes time requirements regardless of whether transactions with time requirements include both a performance and a return obligation. This would result in obligations being recognized as liabilities which do not meet the liability definition. Therefore the IPSASB does not favor such a change.

#### Recognizing time requirements as other resources and other obligations

3.70 In the development of its Public Sector Conceptual Framework the IPSASB issued an Exposure Draft (ED), *Elements and Recognition in Financial Statements*, which proposed that deferred inflows and deferred outflows should be adopted as elements. The objective was largely to deal with the situation outlined above. Following consultation on that ED the IPSASB decided not to define deferred inflows and deferred outflows as elements. However, the IPSASB did accept that “certain economic phenomena that do not meet the definition of any element may need to be recognized in the financial statements in order to meet the objectives of financial reporting.” The IPSASB therefore acknowledged that there may be circumstances where there is a case for

recognizing other economic phenomena that do not meet the definition of an element. The IPSASB believed that using this approach met the objectives of financial reporting because “the circumstances under which other obligations and other resources will be recognized will be determined at the standards level and explained in the Bases for Conclusions of specific standards.”

- 3.71 One approach is therefore to accept that the receipt of resources with time requirements does not give rise to a liability of the recipient but that it is the public interest for the recipient to recognize an “other obligation”. Conversely, the transferor of the resources no longer exercises control of the resource and therefore cannot recognize an asset. However, the usefulness of the financial statements is enhanced by the transferor recognizing an “other resource”.
- 3.72 Some argue that the use of other resources and other obligations is an over-drastring step. It might cause particular problems for jurisdictions where public sector entities report on a mixed group basis. They may acknowledge that there is a problem, but consider that the solution is to use presentational means. These may include one or a combination of the following:
- Note disclosures explaining that resources within accumulated surplus or deficit include resources that the transferor intends for use by the recipient in one or more future reporting periods;
  - Disaggregation of net financial position (net assets/equity) to identify resources that the transferor intends to be used by the recipient in future years ; and
  - Taking resources to net financial position (net assets/equity) and recycling them to surplus/deficit in the year in which the transferor intends them to be used by the recipient.
- 3.73 Those who support these approaches consider that they preserve the integrity of the financial statements by only including the recognition of items that meet the definition of an element while providing users with the information that they need for accountability and decision-making purposes. Others think that presentational approaches do not indicate sufficiently clearly that transactions, such as multi-year year grants are intended to finance activities for periods beyond the reporting period in which they are recognized.

**IPSASB Matter for Consideration 4**

Does the IPSASB wish to express a preliminary view on the issue of time requirements? If so, does the IPSAB favor the use of “other resources” and “other obligations” or the use of one or more presentational methods?

**Specific Matter for Comment 5**

Where an entity transfers resources to a recipient with time requirements, but no conditions do you:

- (a) Favor the use of other resources and other obligations to indicate to users that the transferor intends that the recipient uses the resources in one or more future reporting periods; or
- (b) Consider that the use of other resources and other obligations unnecessary and support the use of one or more presentational mechanisms to provide information to users on transactions with time requirements.

Please explain your reasons.

### *Capital Grants*

- 3.74 The IPSASB has received feedback that the current requirements are ambiguous to apply capital grants. In particular it may not be clear exactly what constitutes a stipulation. For example, some capital grants contain stipulations that the resources must be used to construct or acquire capital assets for delivery of specified services and that if use of the capital asset for delivery of those assets is discontinued the grant is repayable. Is such a stipulation a condition that means that a recipient entity must recognize a liability that it does not derecognize or a restriction? Can the entity argue that it can avoid repayment by continuing to use the asset for the provision of specified services? If a restriction, what should the pattern of recognition be?

### *Advance Receipts*

- 3.75 IPSAS 23 contains guidance on the treatment of advance receipts of taxation and transfers. The IPSASB has received feedback that distinguishing a receipt in advance from another transfer is ambiguous and that the guidance may not be consistent with the requirements and guidance on transfers elsewhere in IPSAS 23.
- 3.76 The guidance states that if an entity receives resources before a transfer arrangement becomes binding (transfers) or a taxable event occurs (taxes) an entity recognizes a liability. The IPSASB does not think that the outcome of this guidance is inconsistent with the requirements and guidance on transfers and taxation elsewhere in IPSAS 23. However, the IPSASB thinks that the guidance should reflect that the relevant factor in determining accounting treatments are the existence of an asset as a result of the transfer of resources and whether there are conditions attached to the transfer of those resources.

### *Services In-Kind*

- 3.77 Currently IPSAS 23 permits but does not require the recognition of services in-kind. The Basis for Conclusions of IPSAS 23 explains that many services in-kind do meet the definition of an asset, and should, in principle, be recognized. It is acknowledged that there may be difficulties in obtaining reliable measurements. Elsewhere services in-kind may not give rise to asset because the reporting entity has insufficient control of the services provided. For these reasons the IPSASB concluded that entities should be permitted, but not required, to recognize services in-kind.
- 3.78 Some argue that the existence of options reduces comparability between entities and that the provisions related to services in-kind should be more clear-cut. The Conceptual Framework's definition of an asset has reaffirmed that services in kind will often meet the definition of an asset. Therefore the assumption should be that services in kind should be recognized provided they can be measured in way that achieves the qualitative characteristics and takes account of the constraints of financial performance. In most cases it will be feasible to obtain a viable measure of the services provided by reference to the cost of obtaining such services in a commercial transaction. However, a contrary view is that the cost of obtaining such information is greater than the benefit to users of the information

### **IPSASB Matter for Consideration 5**

Does the IPSASB wish to express a preliminary view on any of the above issues?

### **Advantages of the public sector performance obligation approach for revenue transactions**

- 3.79 The main advantage of the public sector performance obligation approach is that it removes the need to make judgements about whether revenue and expense transactions are exchange or

non-exchange in character. The analysis of whether a transaction is exchange or non-exchange has proved challenging for many preparers. The difficulty of such judgments is discussed in more detail in Chapter 4. Providing further guidance is not straightforward without creating a voluminous rules-based list of transactions, which is unlikely to be exhaustive and may simply lead to different interpretation issues. Under this view identifying whether a transaction contains a performance obligation(s) will frequently be more straightforward than determining whether a transaction is exchange or non-exchange in character.

- 3.80 The performance obligation approach provides an appropriate basis for accounting for public sector arrangements which are enforceable and require the satisfaction of performance obligations. Under this approach, revenue and expenses will be recognized in the accounting period in which the performance obligations are satisfied. The performance obligation approach supports the objective of faithful representation of an entity's financial performance by recognizing revenue when earned. The performance obligation approach reflects the public interest and supports the presentation of information that allows users to assess the financial effectiveness and efficiency in which a public sector entity satisfies its performance obligations for the benefit of the public.
- 3.81 The Public Sector Performance Obligation approach provides an opportunity to align revenue and expense standard-level requirements and guidance with the principles in the IPSASB's Conceptual Framework.

#### **Disadvantages of the public performance obligation approach for revenue transactions**

- 3.82 The exchange/non exchange classification of revenue and expense transactions is fundamental to IPSASB's literature and is familiar to preparers and users of public sector financial statements. While there may on occasions be classification difficulties, adopting a performance obligation approach may replace one set of interpretation challenges with another—for example, what are distinct goods and services? While it will be clear in many cases whether enforceable arrangements contain performance obligations there will be cases where preparers have to make judgments about whether there are implied performance obligation in arrangements. These judgments may be no more straightforward than determining whether an arrangement is exchange or non-exchange in character. As previously indicated while the exchange/non-exchange distinction has been problematic it is not conceptually deficient.
- 3.83 While extensively modified to reflect public sector circumstances the public sector performance obligation approach is based on a very recent private sector standard. IFRS 15 is not effective until accounting periods commencing on or after 1 January 2018 and therefore it is too early to assess its success. It will take some time for the application of IFRS 15 to be applied to a range of revenue transactions and for consistent interpretations to be established. Consequently it may be some time for any unforeseen outcomes from IFRS 15's application to become apparent. As already noted the IASB has put the effective date back from January 1<sup>st</sup> 2017 to January 1<sup>st</sup> 2018 and in April 2016 issued clarifying amendments. These amendments addressed issues raised by the IASB's Revenue Transition Resource Group –identifying performance obligations, principal versus agent considerations, and licensing. The amendments also provide some transitional relief for modified contracts and completed contracts. Some argue that developing a Public Sector Performance Obligation Approach based on a private sector model that has not had time to 'bed down' is premature.
- 3.84 As discussed in Chapter 2, the IFRS 15 Performance Obligation Approach, involves a five step revenue recognition model. The revenue recognition model will introduce an increased level of complexity, and require the use of estimates and assumptions for certain public sector transactions with performance obligations. The determination when a performance obligation

within an arrangement is identifiable, specific and enforceability could prove challenging when applied to certain public sector transactions.

**IPSASB Matter for Consideration 6**

Does the IPSASB wish to express a preliminary view on whether it supports the public sector performance obligation approach or the exchange/non-exchange approach for dealing with Category B transactions?

**Specific Matter for Comment 6**

Do you favor the public sector performance obligation approach or the exchange/non-exchange approach for dealing with Category B revenue transactions?

If you support an alternative approach please describe this approach.

Please give your reasons

**REVENUE AND NON-EXCHANGE EXPENSES CONSULTATION  
PAPER DRAFT****Chapter 4: Non-Exchange Expenses—Initial recognition***Introduction*

4.1 This chapter discusses the initial recognition of non-exchange expenses. Firstly, it considers difficulties in classifying expenses as exchange or non-exchange in a public sector context. It then highlights the transactions that are within scope of this CP [noting that this is dependent on decisions on the scope and definition of the Social Benefits ED], explains three approaches for initial recognition and evaluates the approaches. Chapter 5 deals with the measurement of non-exchange expenses.

*The Exchange/Non-Exchange Classification of Expenses*

- 4.2 As noted in Chapter 1 the IPSASB's literature does not specifically address accounting for non-exchange expense transactions. In the absence of specific requirements and guidance many preparers have relied on IPSAS 19 for the development of accounting policies for such transactions. As noted in Chapter One IPSAS 19 was derived from IAS 37, which was not developed to address non-exchange transactions. Other preparers have either applied the non-exchange revenue requirements and guidance in IPSAS 23 to non-exchange expenses by analogy or have developed their own policies to ascertain whether a present obligation arises using the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 4.3 The definition of a non-exchange transaction appears superficially clear. However, interpretation and operationalization of the definition can vary significantly. Such variations arise from two distinct yet inter-related issues relevant to the public sector operating environment.
- 4.4 First, as acknowledged in the IPSAB's *Preface to the Conceptual Framework*, most public sector activities are non-commercial in nature and therefore give rise to a large number of non-exchange transactions. Public sector entities regularly engage in transactions for which they either (i) do not receive equal, or approximately equal, consideration for services or resources they provide or (ii) receive consideration the value of which is difficult to measure. As a result, many transactions entered into by a public sector entity apart from commercially-oriented public sector entities could be classified as non-exchange.
- 4.5 Taken to one extreme, it can be argued that all transactions that a non-commercially-oriented public sector entity participates in are fundamentally non-exchange. This notion is based on the premise that a public sector entity is not involved in activities for its own benefit, but rather engages in transactions on behalf of its citizens and other constituents. At the other extreme is the counterpoint to this argument: the notion that all transactions of a public sector entity with performance obligations are fundamentally exchange in nature. This is because a public sector entity will own enter into transactions in furtherance of its own objectives – in some jurisdictions public sector entities may legally only be able to incur expenditure on objectives identified in law. In considering these two extremes, it may be useful to identify who are the "entities" that benefit from these transactions. Outside the public sector environment, the classification of transactions is relatively straightforward. For example, a private sector entity purchases equipment in an arms-length transaction or pays an employee. No one would question that these transactions are clearly exchange in nature—the private sector entity receives the benefit. However, in the public

sector, the parties participating in the transaction, and thus the objective of the underlying transaction, are not always clear.

#### *Non-Exchange Expense Transactions within Scope*

4.6 Non-exchange expenses include:

- Collective goods and services;
- Other transfers in kind; and
- Transfers and grants to other entities.

**[Note to IPSASB. Will need to be updated to reflect developments in the Social Benefits project, particularly definition and scope]**

4.7 Collective goods and services have the following characteristics:

- They are delivered simultaneously to each member of the community or section of the community;
- Individuals cannot be excluded from the benefits of collective goods and services;
- The use of the collective service is usually passive, that is, it does not require the explicit agreement or active participation of all the individuals concerned; and
- The provision of a collective service to one individual does not reduce the amount of that service available to others—it is not exclusive in nature.

4.8 The provision of defense, the conduct of international relations, public order and safety are examples of collective goods and services.

4.9 Transfers to other entities may include detailed conditions and other performance obligations on the part of the recipient, such as specific grants, or may be general transfers to finance the overall activities of an entity. Such general transfers may not include substantive conditions or performance obligations.

4.10 Non-Exchange expenses do not include social benefits as defined in ED xx, *Accounting for Social Benefits* **[insert reference and accompanying detail when scope of ED xx determined]**. Key to the definition of social benefits is the definition of “social risks”. Social benefits protect the entire population, or a particular segment of the population, against certain social risks. Social risks are events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income. In other words, a social risk is an event or circumstance that could adversely affect a household’s budget. The term social risk does not cover other risks that would not impact on a household’s budget. For this reason, certain very significant government expenditures for goods and services provided to individuals and households are not within the definition of social benefits, even though in terms of service delivery they may be very similar to expenditures that are within the social benefits definition. For example, the universal provision of services such as healthcare and education is not within the definition of social benefits, but is clearly a very large expenditure in many jurisdictions.

#### *The Approaches*

4.11 This section explores three approaches to the initial recognition of non-exchange expenses:

- The Expanded IPSAS 19 Approach
- The Public Sector Performance Obligation Approach

- The IPSAS 23 Reverse Approach

### The Expanded IPSAS 19 Approach

- 4.12 As already noted, in the absence of an IPSAS specifically addressing non-exchange expense transactions a number of preparers have used IPSAS 19 to determine accounting policies. The IPSAS 19 approach would formalise this practice. It would bring all non-exchange expenses that do not meet the definition of social benefits within the scope of a revised IPSAS 19 by not restricting liabilities to those of uncertain timing or amount.
- 4.13 Under the Expanded IPSAS 19 Approach the determinant of whether the transferor of resources has an expense and a liability is whether there is an obligating event – that is to say an event that creates a legal obligation or non-legally binding obligation that results in the transferring entity having no realistic alternative to settling that obligation. An obligating event results in a present obligation, and, subject to the satisfaction of recognition criteria, a liability of the transferor.
- 4.14 The Consultation Paper, *Recognition and Measurement of Social Benefits*, issued by the IPSASB in July 2015 put forward a number of possible points at which an obligating event might occur for programs delivering social benefits [Note to IPSASB: this is under consideration in the development of the ED]:
- (a) Key participatory events have occurred
  - (b) Threshold eligibility criteria have been satisfied
  - (c) The eligibility criteria to receive the next benefit have been satisfied
  - (d) A claim has been approved
  - (e) A claim is enforceable
- 4.15 Many of these possible points are relevant to the broader consideration of non-exchange expenses. A public sector entity may have a number of future obligations relating to the provision of collective goods and services and other transfers in kind. Such obligations are an aspect of the ongoing activities of governments and other public sector entities. However, only present obligations gives rise to liabilities. The IPSASB is of the view that collective goods and services do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of those services to beneficiaries. For a government or other public sector entity to recognize an expense and liability for the provision of collective goods and services in future reporting periods is analogous to a manufacturing entity recognizing an expense and liability for the costs of production in future years. Such an approach would not meet the objectives of financial reporting, because it would not provide information that faithfully represents an entity's financial performance or is relevant.

#### **Preliminary View 3**

The IPSASB is of the view that collective goods and services do not give rise to obligating events and therefore expenses or liabilities do not arise prior to the delivery of those services to beneficiaries.

- 4.16 The IPSASB acknowledges that programs delivering other transfers in kind may include eligibility criteria. However, prior to delivery of services the IPSASB thinks it unlikely that the transferor of resources has little or no realistic alternative to avoid settling obligations. Therefore other transfers in kind do not give rise to expenses and liabilities of the transferor prior to the delivery of services.



**Preliminary View 4**

The IPSASB is of the view that other transfers in kind do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of those services to beneficiaries

4.17 The point at which an obligating event occurs for inter-governmental and other transfers to external entities may be the point at which an agreement is signed by both parties or a future point identified in an agreement that identifies actions which give rise to enforceable rights and obligations. However, jurisdiction-specific factors need to be taken into account. In certain jurisdictions, a public sector entity may need to have an approved authorization or appropriation prior to providing funding. In addition, that authorization or appropriation may need to be effective, or not able to be revised or revoked by the transferring entity's governing body, in order to be binding. The requirements related to authorizations or appropriation need to be considered on a jurisdictional basis in determining how they affect the timing of an obligating event.

Advantages of the Expanded IPSAS 19 Approach

4.18 The major advantage of the Expanded IPSAS 19 Approach is that it adopts the same analytical framework that the IPSASB is applying in the ED on social benefits. Because the definition of social benefits that the IPSASB has adopted is linked to the definition of social risks developed and used in statistical accounting the programs providing benefits to those meeting eligibility criteria can be seen as part of a continuum rather than falling within very clearly demarcated categories. Applying different analytical frameworks for programs which have common characteristics runs the risk that very similar transactions will be accounted for differently.

4.19 While IPSAS 19 was developed for exchange transactions the Expanded IPSAS 19 Approach has the merit that it was designed to determine when liabilities (and therefore expense) arises, unlike the other two approaches, which were both derived from models dealing with revenue transactions.

Disadvantages of the of the expanded IPSAS 19 approach

4.20 The main disadvantages of the expanded IPSAS 19 approach are:

- The approach adopts a framework that was not primarily designed for non-exchange expenses;
- The approach adopts a framework designed for the identification of the provisions of uncertain timing or amount rather than specifically for liabilities where the timing and amount of the expenses is clear;
- IPSAS 19 reflects definitions and approaches which are arguably out-of-line with up to date conceptual thinking;
- It is less likely that the timing of recognition of expense and revenue by both parties to an arrangement will coincide than with the other two models; and
- Modifying IPSAS 19 would reduce alignment with IAS 37, although it is likely that in order to reflect the Conceptual Frameworks of the IPSASB and the IASB both IPSAS 19 and IAS 37 will be revised.

4.21 The IPSASB acknowledges these points but does not think that they give rise to insuperable difficulties. The obligating event approach drawn from IPSAS 19 was put forward as one of three potential approaches to determining when expenses and liabilities arise in programs to deliver social benefits in the Social Benefits Consultation Paper. While there was considerable variation in the views of respondents as to the point at which obligating events arise, there was overall support for the approach and far more support than for the other approaches discussed – the

social contract approach and the insurance accounting approach. Respondents did not highlight any other viable approach in addition to the three identified by the IPSASB in the Consultation Paper.

- 4.22 The IPSASB acknowledges that IPSAS 19 contains recognition criteria that will need to be modified to align with the Conceptual Framework. However, the need to amend the recognition criteria so that uncertainty about the flows of service potential or the ability to generate economic benefits is reflected in measurement estimation has been acknowledged and will be addressed in a separate project. IPSAS 19 also contains definitions of a contingent asset and a contingent liability. The conceptual validity of contingent assets and contingent liabilities has been questioned – in both the public sector and the private sector. However, any misgivings about the continuation of contingent liabilities and contingent assets as defined terms does not invalidate the focus on identification of an obligating event that is the central feature of the Expanded IPSAS 19 Approach.
- 4.23 The Expanded IPSAS 19 approach does not attempt to mirror a revenue approach, so it is less likely to lead to consistency of accounting approach. Those who favour resource providers and resource recipients recognizing expense and revenue simultaneously will probably view this as a disadvantage, especially if the two entities are both controlled entities of the same controlling entity.

#### **The Public Sector Performance Obligation Approach**

- 4.24 The Public Sector Performance Obligation Approach for non-exchange expenses is the counterpart to the Public Sector Performance Obligation Approach for revenue transactions discussed in Chapter 3. In essence, the approach to non-exchange expenses involves the transferor of resources recognizing an expense and a liability when the resource recipient satisfies identified performance obligations. The satisfaction of a performance obligation may involve the delivery of services to a resource beneficiary rather than the resource provider. The key characteristics in Chapter 3 have been modified to reflect a non-exchange expense perspective
- (a) The funding arrangements are established through legal or equivalent arrangements (Step 1)
- 4.25 As indicated in Chapter 3, the scope of the public sector performance obligation approach includes arrangements with performance obligations established through legislation or regulation.
- (b) The transaction is defined as a non-exchange transaction involving the satisfaction of performance obligations (Step 2)
- 4.26 In order for a non-exchange expense transaction to be accounted for under the Public Sector Performance Obligation Approach the arrangement must contain performance obligations of the resource recipient. If the arrangement does not contain performance obligations it cannot be accounted for under this approach.
- (c) The arrangement requires the satisfaction of performance obligations, which benefits either the resource provider or resource beneficiary (Step 2)
- 4.27 The IPSASB consider the descriptions of resource provider, resource recipient and resource beneficiary under the Performance Obligation Approach developed for revenue transactions could also be applied to non-exchange expense transactions from the resource provider perspective.
- 4.28 Where the arrangement involves two parties, evaluating whether the resource recipient has satisfied a performance obligation may be relatively straightforward. Tripartite transactions in which a public sector entity (resource provider) provides resources to another entity (resource

recipient) that benefits other parties (resource beneficiaries) may present challenges. In such cases resource providers may need to evaluate arrangements between resource recipients and resource beneficiaries so that information is available in order to determine whether performance obligations of resource recipients have been met. (see also (e) below).

(d) The agreed performance obligations in the arrangement are enforceable (Step 3)

4.29 As indicated in Chapter 3 to apply the performance obligation approach to expense transactions of public sector entities, the definition of enforceability needs be extended to include rights and obligations established through “legal or equivalent means”.

(e) The agreed performance obligations within an arrangement are identifiable and specific (Step 2)

4.30 To apply the public sector performance obligation approach to expense transactions, the funding arrangement must contain performance obligations of a resource recipient that can be separately identifiable by the resource provider. The resource provider must be able to determine if the performance obligations have been satisfied by the resource recipient to determine if a present obligation of the resource provider exists.

(f) The funding provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation (Step 4)

4.31 The total amount of agreed funding will be the amount of consideration the resource provider expects to pay in an enforceable arrangement. The resource provider allocates the total amount of funding to each identifiable and specific performance obligation in an amount that depicts the amount of funding (consideration) the resource provider expects to pay in exchange for satisfaction of the performance obligations.

4.32 If an expense transaction includes an identifiable donation component this should be excluded from the total amount of funding allocated across performance obligations, and recognized as an expense in accordance with the guidance for Category A transactions. This is the mirror of the approach for a resource recipient discussed in Chapter 3.

4.33 The nature of many transactions in the public sector is such that stand-alone prices may not exist for the promised goods and services or other performance obligations described in the enforceable arrangement. In such circumstances it can prove difficult to determine the stand-alone selling price of each identifiable and specific performance obligation within the funding arrangement.

(g) Expense is recognized by reference to when (or as) the resource recipient satisfies the performance obligation (Step 5)

4.34 Under a public sector performance obligation approach, the trigger for expense recognition is when the entity “satisfies the promised performance obligation”. In a transaction involving three parties (resource provider, resource recipient and resource beneficiary), the resource provider recognizes an expense and a liability when (or as) the intended beneficiary has the ability to benefit from the promised good or service delivered by the resource recipient. This approach relies on the resource provider being able to determine that the resource recipient has satisfied the performance obligation. This is particularly important in arrangements where promised goods or services are provided to resource beneficiaries.

4.35 Determining the satisfaction of performance obligations could be evidenced by reporting on progress to the resource provider. This might be a single progress report (for a performance obligation satisfied at a point in time) or a series of progress reports (for a performance obligation satisfied over a period).

**IPSASB Matter for Consideration 7**

Should the six above characteristics be re-expressed so that the analysis mirrors the IFRS 15 Five Step approach in Chapter 2 or is cross-referencing sufficient?

Advantages of the performance obligation approach

4.36 The major advantages of the performance obligation approach are:

- As noted in Chapter 3 the performance obligation approach does not require an entity to assess whether a transaction is exchange or non-exchange in nature. This responds to the classification difficulties identified earlier in this chapter and the views of preparers interviewed who find the non-exchange/exchange classification challenging.
- It may lead to a consistency of accounting approach between resource providers and resource recipients. Because the performance obligations will need to be identified when the funding agreement is entered into by both resource providers and resource recipients and costs/revenue allocated to each performance obligation both resource providers and resource recipients should recognize expense and revenue at the same time and for the same amounts. This will be more easily understandable for users, who may feel that accounting for funding arrangements in which resource providers and resource recipients recognize different amounts at different times is confusing and reflects a lack of accountability that is not in the public interest.
- It may lead to broader beneficial change in public sector financial management because in order to operate the approach, funding agreements must clearly identify the specific deliverables under funding arrangements and the costs/revenue attached to those deliverables.

Disadvantages of the public sector performance obligation approach

- 4.37 The disadvantages identified with the performance obligation model for revenue in Chapter 3 also apply to the modified model for accounting for non-exchange expenses. Some consider that if the consequences of adapting a new recognition model designed for commercial contractual arrangements to non-commercial revenue transactions may be unforeseen, this is likely to be intensified for non-commercial expenses. Like its revenue counterpart, the public sector performance obligation approach can only be applied to non-exchange expense transactions that include performance obligations. Its adoption will therefore still leave a 'literature gap' for non-exchange expense transactions with no performance obligations.
- 4.38 The nature of many transactions in the public sector is such that stand-alone prices may not exist for the promised goods and services or other performance obligations identified in the enforceable arrangement. In such circumstances it can prove difficult to determine the stand-alone selling price of each identifiable and specific performance obligation within the funding arrangement.
- 4.39 The approach depends on regular and robust information flows between resource provider and resource recipient. If information flows are irregular and incomplete the approach is unlikely to provide faithfully representative and relevant information.
- 4.40 The model may lead to inconsistencies with the approach being developed for accounting for social benefits. This may be overstated, as obligating events in the Expanded IPSAS 19 Approach may coincide with performance obligations. However, there is a risk that very similar transactions from similar programs might be accounted for differently.

**The IPSAS 23 Reverse Approach**

- 4.41 The IPSAS 23 Reverse Approach shares similarities with the Performance Obligation Approach in that both are revenue recognition models that are modified in order to provide requirements and guidance for resource providers on the timing of expense recognition. Under the IPSAS 23 Reverse Approach the transferor of resources will determine whether an arrangement for funding contains stipulations. Because conditions are often synonymous with performance obligations, and assuming that resource providers and resource recipients have equivalent information, accounting outcomes are likely to be similar to the Public Sector Performance Obligation Approach. The Revers Approach would reflect revisions arising from the implementation issues considered in Chapter 3
- 4.42 In the case of very straightforward funding arrangements where there are no stipulations, the transferor of resources will recognize an expense (and dependent on the timing of the transfer of resources) a payable. Where there are stipulations the transferor will determine whether these stipulations are conditions or restrictions – see discussion in Chapter 2. If an agreement contains only restrictions the provider will recognize an expense for the entire amount of the funding, because in the event of a breach of a restriction by the recipient the provider has no enforceable right to recover the resources. As discussed in Chapter 2 where there are breaches of restrictions, the transferor may have the option of seeking a penalty against the recipient by legal or administrative processes and such actions may result in a direction that the entity fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. However, as explained in IPSAS 23 such a remedy is the result of the recipient breaching the restriction and is not attached to the transferred resource itself.

**IPSASB Matter for Consideration 8**

This explanation of remedies in the event of a breach of a condition or restriction appears tendentious. Should it be revisited?

- 4.43 If the arrangement contains conditions the resource provider will continue to have an asset until the condition is satisfied by the recipient. This is because in the event of the recipient breaching the condition the provider will have an enforceable right to require the recipient to return the resources and therefore will control those resources until the condition is fulfilled. In many arrangements there will be a number of conditions, so the resource provider will have to determine the amount of the funding that relates to satisfaction of a particular condition, so that a faithfully representative portion of the funding may be recognized.

**Advantages of the IPSAS 23 Reverse Approach**

- 4.44 The main advantages are that:
- The approach uses a template that, despite the implementation issues discussed in Chapter 3, is more mature than performance obligation models and has been applied relatively successfully to public sector transactions;
  - Like the Public Sector Performance Obligation approach it potentially leads to consistency of accounting by resource providers and resource recipients; and
  - It is more versatile than the Public Sector Performance Obligation approach and can deal with expense recognition for transactions that do not contain performance obligations. Therefore it is capable of dealing with both Category A and Category B transactions. Where transactions with performance obligations include a donation component both expenses will be accounted for in the accordance with the same standard. This will mean that

preparers do not have to look to two sources of guidance when dealing with the same transaction.

Disadvantages of the public sector performance obligation approach

- 4.45 Despite certain similarities, unlike the Public Sector Performance Obligation the IPSAS 23 Reverse Approach does require the preparer to determine whether a transaction is exchange or non-exchange in character. It therefore does not address the implementation difficulties on classification highlighted in the second section of this chapter.
- 4.46 Although the model has been applied to non-exchange revenue transactions for a number of years, the model was not designed for expense transactions. Unforeseen consequences may arise – just as with the application of the Public Sector Performance Obligation model to expenses.
- 4.47 In reality, interpreting whether a stipulation is a condition or a restriction may not result in the same conclusions by resource providers and resource recipients. This risks increases when the two parties have access to different information or when there is information asymmetry.
- 4.48 The approach also is subject to the same areas that have given rise to implementation difficulties in IPSAS 23 from a revenue perspective and that have been considered in Chapter 3. For example just as resource recipients have had implementation difficulties with time requirements, resource providers argue that showing a “day one” expense for multi-year general grants does not provide a faithful representative reflection of financial performance or financial position and does not provide relevant, understandable or comparable information.

**IPSASB Matter for Consideration 9**

Does the IPSASB wish to provide a specific matter for comment? If so which approach does the IPSASB favor?

**Specific Matters for Comment 7**

Which, if any, of the three models discussed in this chapter do you support:

Expanded IPSAS 19 Model;

The Public Sector Performance Obligation approach; or

The IPSAS 23 Reverse Approach?

Please explain the reasons for your views. If you do not support any of the three approaches please provide details of the approach that you favor.

**REVENUE AND NON-EXCHANGE EXPENSES CONSULTATION PAPER  
DRAFT****Chapter 5 Measurement****Introduction**

5.1 Previous chapters have principally addressed recognition issues. This chapter discusses the measurement of non-contractual/statutory receivables (hereafter statutory receivables) and non-contractual/statutory payables (hereafter statutory payables)

**Non-Contractual/Statutory Receivables**

5.2 Statutory receivables are receivables that arise from legislation, supporting regulations or similar mechanisms and require settlement in cash or another financial asset. They have some of the features of financial instruments as defined in IPSAS 28, *Financial Instruments: Presentation*, but as the terminology indicates are non-contractual in nature. The majority of transactions do not involve willing parties.

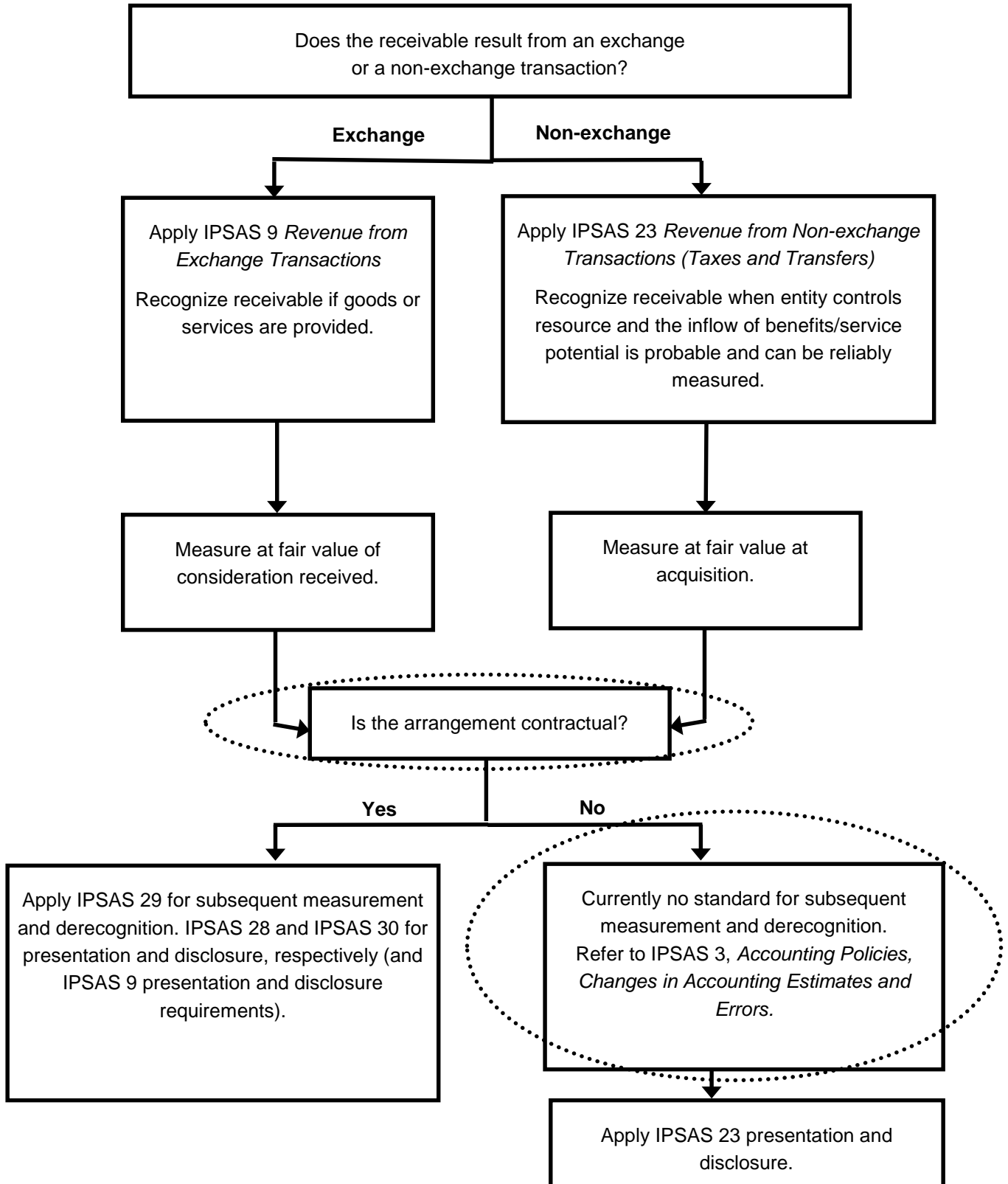
5.3 The principal examples of statutory receivables and payables are

- Taxes;
- Government transfers;
- Fines and penalties;
- Fees; and
- Licenses.

**Current Requirements and Guidance**

5.4 The decision tree on the next page provides an overview of the position in the current literature and identifies the 'gap' for measurement subsequent to initial recognition for non- statutory receivables.

**Diagram One: Recognition and Measurement of Contractual and Non-Contractual/Statutory Receivables—Current Literature**





Measurement at Initial Recognition

- 5.5 As indicated in Diagram One requirements and guidance for the measurement of most statutory receivables at initial recognition is in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. Statutory receivables that are classified as exchange transactions are initially recognized and measured in accordance with IPSAS 9, *Revenue from Exchange Transactions*—these are most likely to be licences and fees. Both IPSAS 9 and IPSAS 23 require initial recognition at fair value.
- 5.6 Some constituents have expressed concern about the appropriateness and interpretation of the fair value requirements in IPSAS 23 for statutory receivables. This particularly applies to taxes, fines and penalties.
- 5.7 The main issue is the determination of fair value, as there is unlikely to be a market for these transactions, and in the unlikely circumstances that there is a market, that market is unlikely to be open, active and orderly. The two options identified by the IPSASB are:
- a) The best estimate of the discounted cash flows expected to be received by the entity. Under this approach, statutory receivables and revenue are initially recognized at discounted value, with no day one impairment expense for amounts expected to be uncollectible; or
  - b) The face value of the transaction(s) with the amount expected to be uncollectible recognized as an impairment
- 5.8 Proponents of option (a) argue that it provides the most realistic and faithfully representative measure of the revenue accruing to the entity. According to this view recognizing revenue for face value amounts, when a large proportion are known to be uncollectible does not provide a faithfully representative measure.
- 5.9 Proponents of option (b) argue that the approach promotes accountability and is in the public interest. Where impairment losses are significant, management and elected officials need to provide explanations. Sovereign power is exercised through the use of constitutionally and legally sanctioned authority. If it is assumed that tax payers and fines-payers are willing to abide by constitutionally and legally sanctioned processes, then it can be argued that they are willing to pay the amount levied. On that basis the initial fair value of receivables arising from the exercise of sovereign power should be the amount owed,

**IPSASB Matter for Consideration 10**

Does the IPSASB wish to provide a preliminary view? If so, please indicate.

**Specific Matters for Comment 8**

Do you agree with option (a) – best estimate of the discounted cash flows –or option (b) – face value of the transaction(s) with the amount expected to be uncollectible recognized as an impairment—for the initial recognition of

## Subsequent Measurement

### Current position and proposed potential approaches

- 5.10 Requirements and guidance on subsequent measurement, derecognition and impairment of non-contractual/statutory receivables is not provided in the current IPSASB literature. In the absence of a standard, jurisdictions have developed their own policies. Those identified by the IPSASB are (i) applying IPSAS 29, *Financial Instruments: Recognition*, by analogy or (ii) developing accounting policies using the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 5.11 This section of the Consultation Paper outlines three potential approaches. These three approaches were discussed in the South African Accounting Standards Board's 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments*.

#### *Approach 1- Fair Value or Market Value Approach*

- 5.12 Under Approach 1 statutory receivables are measured at fair value using the principles in IPSAS 29 by analogy. The rationale is that where statutory receivables are settled in cash or another financial asset they are very similar to financial assets, as defined in IPSAS 29, *Financial Instruments: Recognition and Measurement*, and should therefore be accounted for in a similar manner. Under this approach:
- Present value of the cash flows associated with the receivable determined at each reporting date using a market rate at reporting date;
  - Changes in value since last reporting date recognized in surplus or deficit; and
  - Derecognition, presentation, and disclosure requirements are drawn from IPSAS 28-30.
- 5.13 Going forward this approach would need to be aligned with proposals for updating IPSAS 28-30.
- 5.14 The main issue with this approach is the selection of a market rate. As previously indicated there is unlikely to be a market for many of the transactions arising from statutory receivables. The position is compounded because the credit risk associated with a large number of counterparties, which is a feature of statutory receivables arising from taxes, fines and penalties is extremely difficult to assess. This means that identifying similar financial instruments with the same terms and risk profile is problematic. Under these circumstances reference to a government bond rate is likely to be the only feasible approach. It is also questionable whether an approach with fair value at subsequent measurement is appropriate for relatively straightforward items that are not held for sale or exchange.

#### *Approach 2—Amortized Cost Approach*

- 5.15 Like Approach 1, Approach 2 would apply principles in IPSASB's literature on financial instruments by analogy. However, subsequent measurement is at amortized cost, rather than fair value. Under this approach the present value of the cash flows associated with the receivable would be determined using the effective interest method and discounted using the original effective interest rate. In practice the original effective interest rate is likely to be the market rate at transaction date, as even if interest is levied it is unlikely to be market-related. Under the Amortized Cost Approach, an entity would

assess where there is an indication of impairment, and if such an indication exists, would assess the cash flows to determine if the receivable is impaired.

- 5.16 The main advantage of Approach 2 is that it reflects the accounting at subsequent measurement of loans and receivables in IPSAS 29, which are the vanilla financial instruments that statutory receivables most obviously resemble. Approach 2 does not require a fair value remeasurement at each reporting date, which is likely to be very onerous and also of questionable practicality. However, Approach 2 shares many of the same complexities as in Approach 1 in terms of identifying market rates. In addition, assessing the cash flows of receivable at reporting date to determine if the receivable is impaired is likely to be onerous.

*Approach 3—Cost approach*

- 5.17 Approach 3 relies on the principles in IPSAS 26, *Impairment of Cash-Generating Assets*. Under this approach subsequent measurement is at the lower of carrying value and recoverable amount. An entity accrues interest only if interest is levied under the terms of the arrangement. As in Approach 2 an entity assesses whether there is an indication that a receivable is impaired. If there is such evidence any impairment loss is calculated as the difference between the estimated future cash flows (discounted if appropriate) and the carrying amount. This approach would apply the disclosure requirements in IPSAS 26.
- 5.18 Approach 3 has the advantage of avoiding what are likely to be arbitrary decisions on market interest rates, although decisions on appropriate interest rates will still have to be made if discounting is required for impairment purposes. The disadvantage is that it ignores the fact that receivables are financing transactions and excludes the cost of financing from measurement. Some also argue that treating statutory receivables differently to other receivables that they only differ from because they are non-contractual is difficult to justify and that using an impairment standard designed for tangible and intangible assets is counter-intuitive. The rejoinder to this argument is in the section on statutory payables (see below).

**IPSASB Matter for Consideration 11**

Are these the three approaches that the Consultation Paper should identify? In particular Approach 1 appears to have few advantages and many impracticalities? Do you support Approach 2 or Approach 3? Should there be a preliminary view?

**Specific Matter for Comment 9**

Which of the three approaches identified in this chapter for the subsequent measurement of statutory receivables to do you support:

- (1) Fair Value of Market Value approach; or
- (2) Amortized Cost Approach; or
- (3) Cost Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

### Non-Contractual/Statutory Payables

5.19 The definition of statutory payables mirrors that of statutory receivables – outflows for transactions that do not arise from contracts, but have many of the features of a financial instrument. Such transactions principally include:

- Taxes payable;
- Appropriations and grants to recipients;
- Repayments of grants; and
- Fines and penalties such as those applied by a regulator.

5.20 Social benefits are outside the scope of the Consultation Paper, as are transactions with characteristics of insurance contracts

Current position and proposed potential approaches

5.21 There are no requirements specific to non-exchange expenses in the current IPSASB literature.

5.22 IPSAS 19 requires both measurement at initial recognition and subsequently as “the best estimate of the expenditure required to settle the present obligation at the reporting date.”

5.23 This section of the Consultation Paper outlines three potential approaches. These three approaches were discussed in the South African Accounting Standards Board’s 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments*.

Approach 1–Best Estimate for Settlement Approach

5.24 This approach requires subsequent measurement as the best estimate of the amount required to settle the liability, using discounted cash flows where appropriate. In accordance with the IPSASB’s Conceptual Framework the rebuttable presumption is that this is on a cost of fulfillment basis, i.e., the cost that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. There may be very limited occasions where cost of release is the appropriate measure. Cost of release is the amount that a third party would charge to accept the immediate transfer of the liability from the reporting entity. Cost of release will only be relevant when it is both feasible and the most resource efficient approach to settlement of the liability (i.e., when cost of release is lower than cost of fulfillment). The absence of a market will limit these occasions.

5.25 The advantage of this approach is that it is in accordance with Framework, relatively straightforward to apply and produces understandable information. Those who consider that the similarities between statutory receivables and contractual receivables can be exaggerated favor it. Those who consider that statutory and contractual receivables are similar question why statutory receivables are not accounted for in the same way as the financial instruments they resemble.

Approach 2– Amortized Cost Approach.

5.26 Approach 2 mirrors the amortized cost approach for statutory receivables. Initial measurement is at fair value and subsequent measurement at amortized cost using the effective interest rate method. Fair value at initial recognition would likely equate to transaction price, unless evidence exists to the contrary. The effective interest rate would be the market-related interest rate determined at initial

recognition The advantages and disadvantages of this approach mirror those of its counterpart for statutory receivables – principally identifying a market rate at the transaction date. Conversely to Approach 1 it is favored by those who consider that statutory receivables and contractual receivables are similar and should therefore be accounted for similarly and opposed by those who consider that the similarities between statutory receivables and contractual receivables can be exaggerated, particularly where statutory receivables are involuntary transactions

#### Approach 3: Hybrid Approach

5.27 Approach Three adopts a dual approach. If the timing of cash flows from statutory payables is certain in timing and amount they should be accounted for under Approach Two. If the timing is uncertain in timing and amount they should be accounted for under Approach One. The rationale for this approach is that statutory payables with cash flows that are certain in timing or amount more closely resemble financial instruments as defined than those with cash flows that are certain in timing or amount. Under this approach transactions with identifiable counterparties

#### **IPSASB Matter for Consideration 12**

Are these the three options that the Consultation Paper should identify? Staff supports Approach One because:

It is more in accordance with the Conceptual Framework.

The similarities between statutory payables and financial liabilities can be exaggerated. The difference between contractual arrangements with willing parties and those with no willing parties is fundamental.

The accounting treatment is more understandable for users.

It is more straightforward to implement as it does requires fewer decisions on interest rates, although it does require selection of an interest rate for discounting) where settlement is in the medium to long term.

Does the IPSASAB want to provide a preliminary view?

#### **Specific Matter for Comment 10**

Which of the three approaches identified in this chapter for the subsequent measurement of statutory receivables do you support:

(1) Best Estimate for Settlement Approach; or

(2) Amortized Cost Approach; or

(3) Hybrid Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

**APPENDIX A*****INTERVIEWS WITH PREPARERS*****Introduction and Background**

1. In order to obtain feedback from constituents regarding the specific issues addressed in the Revenue and Non-Exchange Expense projects, the project staff conducted interviews of preparers and users.
2. For the Revenue project, the objective of the outreach was to obtain feedback from preparers of public sector financial statements about their experience of accounting for non-exchange revenue under IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The project staff was particularly interested in feedback on the accounting for non-exchange revenue with restrictions, including timing and purpose restrictions.
3. As explained in Chapter 2, the IPSASB currently does not have a standard on accounting for non-exchange expenses. However, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, although it does not directly address non-exchange transactions, applies to a public sector entity that provides resources in non-exchange transactions. The objectives of the outreach for the non-exchange expense project were (1) to obtain feedback from preparers of public sector financial statements about how the standards have worked in practice and (2) to identify other issues that have arisen in implementation.
4. The objective of the outreach to users of public sector financial statements, both for the Revenue and the Non-Exchange Expenses Projects, was to obtain feedback about whether users are receiving the information required about non-exchange transactions, as well as how this information is used for accountability and decision-making purposes..
5. This appendix presents the methodology for the interviews of preparers and its limitations. The appendix then presents the research topics and results.

**Methodology and Limitations**

6. The interview protocol materials provided to interview participants in advance of the scheduled interviews were developed through coordinated efforts of the project staff for both teams. Separate interview protocols were developed for preparers and for users.
7. Interview participants were selected through identification of public sector entities that have implemented accrual IPSAS (or that use other accrual standards and refer to IPSASs for items not addressed by those standards). Input was received from IPSASB members on the identification of public sector entities to contact.
8. Interviews of preparers generally were conducted by phone. Representatives from both project teams participated in the interviews as schedules permitted. Some interviews were conducted in person and one interview was conducted via video conference.
9. In addition to the interviews, some respondents also provided written answers to the interview materials with the opportunity for additional follow up verbally if needed.

10. Figure 1 below presents the number of public sector entities with representatives who participated in the interviews and the method by which the interviews were conducted.

**Figure 1 – Preparer Interview Participants**

	<b>Central Government</b>	<b>Sub-National Government</b>	<b>International Organization</b>	<b>Total</b>
Teleconference	3	1	0	4
Video Conference	1	1	0	2
In Person	1	0	1	2
Written Responses	1	1	1	3
Total	6	3	2	11

11. The interviews were recorded and transcribed; however, interviewees were assured that no public sector entity would be associated with a specific response. The responses to the questions were summarized while retaining as much of the interviewees language as possible for use in analysis and presentation in this paper.
12. A limitation of this interview research approach was the lack of representativeness of the sample to populations of all preparers of public sector entity financial statements using accrual IPSAS (or referring to IPSASs). Efforts were made to select interview participants that prepare financial statements for different sizes and types of entities; however, the participants were not selected using a random process, nor were the findings analyzed using statistical techniques. Consequently, the information obtained from the interviews may be representative of the views of the larger population of preparers, but are not generalizable.
13. Representative comments included in the following sections may be summarized or paraphrased from the interview transcripts.

**Research Topics and Results**

14. The topics covered in questions for both revenue and expense were very similar and therefore are presented jointly in this section.
15. To form a base for the discussion, preparers were first asked to identify the types of non-exchange revenue and expense that exist for the respondent’s jurisdiction. Respondents noted the following non-exchange revenues and expenses (items listed in the first category below were mentioned as potential sources of both non-exchange revenues and non-exchange expenses):

<b>Both Non-Exchange Revenues and Non-Exchange Expenses</b>
<ul style="list-style-type: none"> <li>• Taxes</li> <li>• Grants</li> <li>• Subsidies</li> <li>• In-kind contributions</li> <li>• Transfers</li> <li>• Premises, goods, inventory</li> </ul>

### Non-Exchange Revenues

- Fines
- Voluntary contributions
- Assessed contributions
- License fees
- Refuse charges
- Home installation
- Business improvement targeted rates
- Building consents
- Social housing
- Membership assessments
- Waiver of fees

### Non-Exchange Expenses

- Public health or public services, including humanitarian-type aid and unemployment-type aid
- Funding to partners for specific programs
- Pass-through contributions (governments to citizens)
- Concessionary loans
- Investment contributions to recipients
- Donations

16. After identifying the types of transactions in each respondent's jurisdiction, preparers were then asked to identify any difficulties the preparers had with recognition, measurement, or disclosure of those non-exchange revenue or expense previously identified by the respondents. Participants noted the following difficulties:

### Difficulties Relevant to Non-Exchange Revenues

- Treatment for arrangements that include stipulations and whether those stipulations are conditions or restrictions
- Timing of recognition, especially for multi-year pledges received at the beginning of the arrangement
- Use of models to estimate accruals and the timing of the taxable events
- Correct recording of pass-through transactions, including taxes
- Treatment of in-kind services received
- Difficulties stemming from the underlying tax legislation as opposed to conceptual issues
- Level at which to assess non-exchange or exchange classification (transaction or activity level)
- Application of probability of collection at initial recognition or subsequent measurement
- Financing of construction projects
- Distinguishing between exchange and non-exchange transactions
- Analyzing non-standard contribution agreements for recognition and measurement of revenues and liabilities
- Treatment of foreign exchange liabilities



### Difficulties Relevant to Non-Exchange Expenses

- No issues
- Treatment of expenses over multiple years, including contributions and forbearance loans
- Application of the “more likely than not” threshold in IPSAS 19 in practice
- Defining an onerous contract
- Measurement of the expense
- Concessionary, forbearance, and conditional loans
- Fiscal equalization based on statistical predictions

17. Some representative comments from the interviews involving the difficulties noted above are as follows:

### Difficulties Relevant to Non-Exchange Revenues

*We have difficulties in determining the nature of a stipulation – especially the stipulation concerning time boundary of resource – as either a condition or a restriction.*

\*\*\*

*One of the challenges we face...relates to multi-year pledges. We currently recognize 100% of the revenue up front (unless there are conditions); however, we foresee this changing in the future and would look for clear guidance from the IPSAS Board on the timing of revenue recognition in such cases, with the hope that the underlying process supporting this will not be overly burdensome.*

### Difficulties Relevant to Non-Exchange Expenses

*Fiscal equalization – calculated in two versions. One is based on the income taxes in the year. Easy for accounting and accrual. Second is based on statistical amounts from prior years. Can be based on mix of inhabitants and income. Can be predictable based on historical trends. Problem under IPSAS 19 is when one city has a one-year increase. Due to statistics, the city may know that they will have an increase in three years based on that year's statistics. Not clear under IPSAS 19 if this should be accrued by city. Guidance in non-exchange standard would be helpful for this transaction.*

\*\*\*

*Forbearance loans – give money away but do not intend to get back; recorded as expense; issue here of multi-year amounts paid when specified investment conditions are not clear. Should the entire amount be accrued when agreement is made or ¼ per year? Amounts are paid each year, not at the beginning of the agreement, but the decision to not require repayment is made at the beginning of the agreement. Cash flow mirrors intention of funding for multiple years, but no chance to avoid outflow in years 2-4 as decision was already made in year 1.*

\*\*\*

*The definition of a condition is a very high threshold in IPSAS 23; therefore, we were not able to argue that our advances were subject to conditions sufficient to justify the recording of an asset related to the funds advanced. We feel this is more cash-basis accounting than accrual and is inconsistent with the treatment of multi-year contributions described earlier. The inconsistencies and subjectivity makes it difficult to apply the standards.*

18. Preparers were then asked to share their views on the sufficiency of guidance in current IPSAS literature regarding the distinction between exchange and non-exchange revenues and expenses. Although that distinction was noted as a difficulty in the previous question, responses to this specific question were more varied. Some respondents indicated that the current IPSAS literature was sufficient, while other respondents stated that the IPSAS literature was insufficient. Some respondents who indicated the guidance was insufficient noted that, for certain transactions, such as fees and licensing, classifying the transaction as a fee for service or a tax by a different name was challenging.
19. The portion of the interview related to non-exchange expenses also sought to understand certain aspects of the accounting for and reporting of non-exchange expenses that might not be as relevant to the discussion of non-exchange revenues. Given the lack of specific guidance in current IPSAS literature, the questions related to non-exchange expenses also asked respondents if they generally needed to record accruals for non-exchange expense transactions, as well as any guidance the entities may have consulted to determine the proper recording of non-exchange expense transactions.
20. When asked if non-exchange expenses currently required the recording of accruals, respondents gave mixed answers. Some reported that accruals were made if the agreements had full legal force, but were not yet invoiced. Others reported that accruals were recorded if there was a commitment to pay, even if there were no direct benefits. Still others reported that accruals were disclosed if the

goods or services received could be verified as received and the amount was quantifiable. Some respondents indicated that accruals were not being made or were not significant.

21. Respondents also reported a wide range of guidance that had been consulted when the respondents were considering the recognition of these non-exchange expenses. Among the sources were IPSAS 23, IPSAS 25, *Employee Benefits*, and IPSAS 29, *Financial Instruments: Recognition and Measurement*. Some respondents used International Accounting Standard 20, *Accounting for Government Grants and Disclosure of Government Assistance*, while others consulted with auditors or accounting firms. Some also consulted commercial law or accounting guidance of a standard setting group within their entity's jurisdiction.
22. The final question of the interview sought to understand the prevalence of stipulations – specifically time or purpose restrictions – on the transactions of the entities. With regard to non-exchange revenues, many respondents indicated that they received resources with time or purpose restrictions. Some respondents indicated that restrictions do not affect the recording of the transactions, but that conditions would affect the recognition. With regard to non-exchange expenses, many respondents with significant non-exchange expenses reported that the resources provided to recipients generally have either a time restriction, purpose restriction, or both. The respondents generally noted that the restrictions do not affect how the transactions are recorded, as there is not typically a return obligation included in the restriction. Failure to comply with restrictions may affect future funding levels, but do not require the return of funds. The following comments were taken from the interview responses:

#### **Stipulations Imposed on Non-Exchange Revenues**

*Almost all the contracts have restrictions. In voluntary contributions agreements with conditions, a liability is recognized and the revenue is not recognized until the liability is fully discharged....Voluntary contributions with restrictions are recorded when the agreement becomes binding.*

\*\*\*

*We would welcome some clearer guidance and examples in the standard and simplification of conditions, stipulations and restrictions and recognition within the standard or the examples provided that are not government organizations only and recognize multi-year donations and clear requirements/guidance for accounting of those.*

#### **Stipulations Imposed on Non-Exchange Expenses**

*We do request an implementation report from the contractual partner and further grants / instalments are not paid if there is a failure in compliance. However, as disbursements are recognized as an expense, it does not affect recording of a transaction.*

\*\*\*

*We do request verification of restrictions being met, but the expense is recorded at disbursement, so it doesn't affect the recording.*

### **Summary and conclusion**

23. The survey confirmed that public sector entities engage in a variety of non-exchange transactions, both revenues and expenses. The difficulties noted by the interview participants often varied

depending on the types of transactions encountered. However, some common implementation issues emerged.

24. Interview participants generally noted challenges in accounting for multi-year funding arrangements. Some recipients also noted that accounting for stipulations caused challenges. Elsewhere, respondents indicated that certain transactions, such as licenses and fees, were difficult to classify as exchange or non-exchange revenue. However, many respondents did not indicate concern with the distinction between exchange and non-exchange transactions on a conceptual level. .
25. Interview participants generally did not indicate significant issues with the accounting for or reporting of non-exchange expense. However, some interviewees did indicate that clearer guidance for non-exchange expenses than that provided in IPSAS 19 would be welcome. Many respondents with concessionary or forbearance loans also indicated that the accounting for such loans often was challenging. Application Guidance for concessionary loans is provided in IPSAS 29.

## APPENDIX A: PREPARER INTERVIEW PROTOCOL DOCUMENT

### Accounting and Financial Reporting for Non-Exchange Revenues and Non-Exchange Expenses

#### Outreach Questions for Preparers of Public Sector Financial Statements

##### *Introduction*

The IPSASB has recently commenced projects on accounting for revenues (covering both exchange and non-exchange) and accounting for non-exchange expenses (excluding social benefits).

The staff involved in the projects want to understand any issues preparers have with the current requirements in the IPSAS literature, to help focus the work to be done in each of the projects.

Non-exchange transactions are defined in IPSAS 9, *Revenue from Exchange Transactions*, as:

*Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.*

Further information about the revenue project is available [here](#), and further information about the non-exchange expenses project is available [here](#).

##### Objective of the outreach for non-exchange revenue

IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* is the current standard for accounting for non-exchange revenue (for example, taxes and certain grants). The objective of the outreach is to get feedback from preparers of public sector financial statements about their experience of accounting for non-exchange revenue under the current IPSAS literature. In particular we are interested in feedback on the accounting for non-exchange revenue with restrictions, including timing and purpose (for example, how a grant is required to be used) restrictions.

##### *Non-exchange revenue questions*

1. What type of non-exchange revenues do you have?
2. What difficulties do you have with recognition, measurement or disclosure for these revenues based on the current IPSAS literature?
3. In the current IPSAS literature, is there sufficient guidance to distinguish exchange revenues from non-exchange revenues?
4. As a public sector entity that receives resources, how often do those resources have time restrictions or purpose restrictions? How do these restrictions affect the way you record the transaction?

##### *Objective of the outreach for non-exchange expense*

The IPSASB currently does not have a standard on accounting for non-exchange expenses. However, IPSAS 19, although it does not directly address non-exchange transactions, applies to a public sector entity that provides resources in non-exchange transactions. There is no other specific guidance to address these non-exchange transactions.

The objective of the outreach is to get feedback from preparers of public sector financial statements regarding how the standards have worked in practice and to identify any issues that the IPSASB may need to address.

*Non-exchange expense questions*

1. What types of non-exchange transactions do you participate in as a public sector entity that provides resources?
2. Which of these transactions, if any, have you had difficulty accounting for under IPSAS 19? What was the nature of that difficulty?
3. Do you generally need to record accruals (for example, assets or liabilities) for these transactions at year-end? If so, how do you determine the amount of the accrual?
4. When considering the recording or reporting of these transactions, what guidance, if any, have you consulted?
5. As a public sector entity that provides resources, how often do you impose time or purpose restrictions on the resources that you provide to public sector and private sector entities? How do these restrictions affect how you record the transaction, if at all?