

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: New York, USA

Meeting Date: March 8-11, 2016

Agenda Item 11

For:

☐ Approval

☒ Discussion

☒ Information

Non-Exchange Expenses

Objectives of Agenda Item

1. The overall objective of this item is to seek feedback from the IPSASB to assist in drafting several chapters of the Consultation Paper for revenue and non-exchange expenses. Specifically, staff are seeking feedback regarding the measurement basis for liabilities that arise from non-exchange transactions and two potential alternatives to the recognition of non-exchange expenses.
2. Staff are also seeking feedback on the preliminary outline of the Consultation Paper and the drafts of Chapter 1, Appendix A and Appendix B.

Materials Presented

- Agenda Item 11.1 Issues Paper – Non-Exchange Expenses, Measurement
- Agenda Item 11.2 Issues Paper – Non-Exchange Expenses, Alternatives
- Agenda Item 11.3 Consultation Paper Draft Outline
- Agenda Item 11.4 Consultation Paper – Chapter 1, Appendix A and Appendix B

Action Requested

3. The IPSASB is asked to provide feedback on the Matters for Consideration in Agenda Papers 11.1 and 11.2.
4. The IPSASB is asked to provide feedback on the draft Consultation Paper outline.
5. The IPSASB is asked to provide feedback on the draft Chapter 1, Appendix A and Appendix B of the Consultation Paper.

ISSUES PAPER, *NON-EXCHANGE EXPENSES – MEASUREMENT***Introduction**

1. The objective of this paper is to determine a measurement basis to be used in the guidance developed for non-exchange transactions of resource providers. Although a joint consultation paper is being developed for revenue and expenses, the measurement basis for revenues is defined in existing IPSASB literature and in the performance obligation approach being considered. This paper describes the potential bases for measurement of liabilities and related expenses that are not social benefits and that are not within the scope of other existing IPSASB literature. The paper then applies the potential bases to two examples of non-exchange expenses and recommends a measurement basis.

Potential Measurement Bases

2. Chapter 7 of the Conceptual Framework describes the objective of measurement as follows:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.

The Conceptual Framework also notes that the selection of a measurement basis contributes to meeting the objectives of financial reporting by providing information that enables users to assess the cost of services provided in the period, the capacity of the entity to support the provision of services in future periods, and the capacity of the entity to fund its activities. The selection of measurement bases also must consider the qualitative characteristics of financial reporting.

3. The Conceptual Framework describes the following five potential measurement bases for liabilities:
 - historical cost
 - cost of fulfillment
 - market value
 - cost of release
 - assumption price.
4. Historical cost for a liability is defined in the Conceptual Framework as “the consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.” Historical cost is appropriate where liabilities are likely to be settled at stated terms; however, historical cost cannot be applied for liabilities that do not arise from transactions (damages from a tort or civil damages). The Conceptual Framework also notes in paragraph 7.73 that historical cost is unlikely to provide relevant information when the liability has been incurred in a non-exchange transaction, because historical cost does not provide a faithful representation of the claims against the resources of the entity.
5. The cost of fulfillment is “the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.” If the cost of fulfillment depends on

uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment. The Conceptual Framework notes the cost of fulfillment is generally relevant for measuring liabilities except in the following circumstances:

- (a) The entity can obtain release from an obligation at a lower amount than cost of fulfillment
- (b) Liabilities are assumed for consideration (assumption price is more relevant when it is higher than both cost of fulfillment and cost of release).

Non-exchange transactions in which a public sector entity is providing resources generally do not meet either exception described above.

- 6. Market value is the “amount for which a liability could be settled between knowledgeable, willing parties in an arm’s length transaction.” Market value may be appropriate for the measurement of a liability if the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market. If the transfer of a liability is restricted and the terms of such a transfer are unclear, the use of market value is unlikely. Non-exchange transactions of resource providers are not generally attributed to changes in rates, prices, or indexes described above, and are unlikely to be settled through a market transaction; therefore, the use of market values to measure liabilities arising from non-exchange transactions is not likely.
- 7. Cost of release refers to the amount of an immediate exit from the obligation, which represents the amount either the creditor will accept in settlement of its claim, or a third party would charge to accept, the transfer of the liability. The cost of release refers to the same concept as “net selling price” in the context of a measurement basis for assets. For some liabilities in the public sector, the transfer of a liability is not practically possible and the cost of release will be the amount the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor. To assess the use of cost of release to measure liabilities, it is necessary to consider whether the release is an option that is open to the entity in practice. The cost of release is relevant only when the most resource-efficient course available to the entity is to seek immediate release. If the cost of fulfillment, for example, is lower than the cost of release, cost of fulfillment provides more relevant information even if an immediate release is feasible.
- 8. Assumption price is “the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price—that is not the case for non-exchange transactions.” The Conceptual Framework notes this measurement basis will not be applicable to non-exchange transactions. The consideration of examples later in this paper therefore does not include an evaluation of the assumption price measurement basis.

Current and Proposed IPSASB Guidance

- 9. Non-exchange expenses are currently in the scope of guidance provided in IPSAS 19. IPSAS 19 requires that the amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the reporting date. The best estimate of the expenditure is the “amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time.”
- 10. IPSAS 19 notes management must use judgment to estimate the outcome and financial effect. Management’s judgments may need to be supplemented by reports of independent experts and

additional evidence provided by events after the reporting date. IPSAS 19 also requires risks and uncertainties surrounding events and circumstances to be taken into account when developing the best estimate of a provision. If the effect of the time value of money is material, the provision should be recorded at the present value of the expenditures expected to be required to settle the obligation.

11. The social benefits project presents options for recording liabilities for social benefit programs in the Consultation Paper (CP), *Recognition and Measurement of Social Benefits*, which include the obligating events approach, the social contract approach, and the social insurance approach. As highlighted below, the obligating events approach is considered to have the most applicability to the discussion of non-exchange expenses that are not social benefits and potentially would be in the scope of this project.
12. The obligating events approach describes the cost of fulfillment as the most appropriate basis for the measurement of a liability. The social benefits CP notes that the other measurement bases for liabilities are not likely to be appropriate for the following reasons:
 - There may be no consideration on which a historical cost value can be based (historical cost)
 - It is unlikely that there will be a market value for social benefits (market value)
 - The transfer of a liability for social benefits will rarely be possible (cost of release)
 - The liability for social benefits is generally a result of an entity's own actions rather than one that is assumed by the entity (assumption price)

Application to Non-Exchange Expenses

13. To illustrate the potential application of the measurement bases for liabilities described in the Conceptual Framework, this section considers the application of four measurement bases (historical cost, cost of fulfillment, market value, and cost of release) to two examples of non-exchange expenses: a grant from one public sector entity to another and a subsidy from a public sector entity to an individual.

Grant Example

14. In the first example, a central government (resource provider) provides a grant to a local government health department to subsidize a portion of a vaccination program for residents of the community. The resource provider will pay 50 percent of the actual costs for 500 vaccinations, up to CU50 for each vaccination. The resources to be paid are based on the actual number of vaccinations provided and are paid on a pro rata basis at the end of each month. At the end of the reporting period, the agreement has been in effect for one month and no payments have been made. The local health department has provided 400 vaccinations at a cost of CU100 per vaccination.
15. Historical cost of the grant does not exist. Although the grant includes stated terms for the portion of the cost of each vaccination provided the resource provider will pay and the maximum amount of the grant, the ultimate settlement depends on the total number of vaccinations provided by the local government health department. Therefore, historical cost is not a relevant measure of the liability in this situation.
16. The cost of fulfillment, or costs the central government will incur to fulfill the obligation to the local health department, depends upon the number of vaccinations completed by the local health department. If the cost of those vaccinations are uncertain at the reporting date, the central

government's cost of fulfillment should therefore consider all possible outcomes related to the uncertainty. The local health department has completed 400 of the 500 maximum vaccinations allowed within one month of the agreement's beginning date. The central government would consider all possible outcomes to determine the cost the central government will incur to fulfill the obligation.

17. To apply the market value measurement basis, the central government would need to determine that there is an active, orderly market for grants to provide to vaccination services. If there is no market participant who would settle this transaction on behalf of the entity in an arm's length transaction, the use of market value would not be appropriate.
18. In order to obtain an immediate exit from the obligation to provide funding to the local health department and apply the cost of release measurement basis, the central government would need to find a third party to accept transfer of the liability. Because the benefits of the transaction do not flow directly to the central government, a third party is unlikely to accept or pay for transfer of the liability. Moreover, the central government is unlikely to be able to transfer such a liability. As the option to transfer the liability is not likely open to the central government, the central government may not be able to apply the cost of release measurement basis.

Subsidy Example

19. To further illustrate the application of the potential measurement bases to non-exchange transactions of a resource provider, the second example considers the payment of a subsidy to producers of a product within a central government's jurisdiction. The market price of the product is CU100 per unit; however, the central government has a policy to make the product more affordable to its constituents. The central government will pay producers of the product CU50 per unit if the units are sold to the residents of the central government's jurisdiction for CU50. Producers are required to submit sales information to the central government in order to obtain the subsidy. Sales information provided to the central government for the reporting period indicates that 1 million units were sold at the required price of CU50 per unit.
20. Historical cost of the subsidies does not exist. Although the subsidy includes stated terms per unit, ultimate settlement depends on total produced. Therefore, historical cost is not a relevant measure of the liability in this situation.
21. The government will incur costs of CU50 million to fulfill its obligation to provide the subsidies. The cost of fulfillment is not subject to uncertainty in this case as the central government knows the cost to fulfill the subsidies to the producers.
22. A market value for the payment of subsidies is not likely to be available. The payment of subsidies is not an activity that would generate market activity; therefore, the use of market value as a measurement basis is unlikely.
23. In a similar manner as the grant example above, the central government does not receive direct benefit from the payment of the subsidies. The subsidies are paid to the producers for sales made to residents of the central government's jurisdiction, not necessarily the central government itself. Therefore, a third party is not likely to be willing to accept or pay for the liability to pay the subsidies. The cost of release measurement basis would not likely apply.
24. Through evaluation of the examples above, the historical cost measurement basis does not exist for these non-exchange transactions of a resource provider. Although the cost of fulfillment measurement basis may be more likely to apply to the measurement of liabilities that arise from non-

exchange transactions of resource providers, the market value and cost of release measurement bases may have some applicability. The Conceptual Framework provides limited guidance on the selection of a measurement basis; however, the qualitative characteristics can be used to further the evaluation of the alternatives.

Qualitative Characteristics

25. This section discusses the consideration of the qualitative characteristics described in the Conceptual Framework for the market value, cost of fulfillment, and cost of release measurement bases. As noted above, the Conceptual Framework provides a limited discussion of the application of the qualitative considerations to measurement bases for both assets and liabilities (for example, paragraphs 7.19-7.21 describe the application of the qualitative characteristics to the historical cost measurement of assets). When the same or similar measurement basis is used, such as market value, the Conceptual Framework provides the discussion related to assets and does not repeat the consideration for liabilities.

Relevance

26. The first qualitative characteristic considered is that of relevance. The Conceptual Framework states that financial and non-financial information is relevant if it is “capable of making a difference in achieving the objectives of financial reporting.” Such information is capable of making a difference when it has confirmatory value, predictive value, or both. To have confirmatory value, the information should confirm or change past expectations, for example, expectations related to matters such as the extent to which managers have discharged their responsibilities for the efficient and effective use of resources, the achievement of specified service delivery objectives, and compliance with budgetary, legislative or other requirements. Predictive value can be provided by information about economic or other phenomena that exist or have already occurred by helping form expectations for the future. Information about the current level of claims on resources can help users confirm the outcome of management strategies during the period and to predict the entity’s ability to respond to future changes.
27. Information provided by the measurement of liabilities that arise from non-exchange transactions of resource providers will likely be used to determine if management has efficiently used resources and if service delivery objectives have been met. Expectations of the typical manner in which a non-exchange transaction is completed by a resource provider are less likely to include settlement through a market transaction or through transferring the liability to a third party. Users are likely to expect a public sector entity to settle the transaction by providing the services or making payments to recipients as specified in the related agreements. The cost of fulfillment is more likely to provide information needed to confirm users’ expectations regarding the settlement of these liabilities.
28. To provide predictive value, the measurement of liabilities that arise from non-exchange transactions of resource providers must be able to assist users in forming expectations for the future. As described above, users are likely to expect a public sector entity to fulfill an obligation in a non-exchange transaction through payment to the recipients, not through a market transaction or transfer of a liability. If these liabilities were to be measured using market value or cost of release, that basis may not provide much predictive value for the future settlement of liabilities. Although a market may exist for a non-exchange transaction of a resource provider at a point in time or in isolated cases, it may not be likely that the market will be open, active, and orderly. Similarly, although a public sector entity may be able to transfer a liability to a third party in certain circumstances, the situation may not be

likely to occur in the future. The option to fulfill a liability by payment to the recipient through the terms of the arrangement should continue to exist for the public sector entity. The cost of fulfillment measurement basis therefore is most likely to provide information that is relevant to users of financial statements.

Faithful Representation

29. Information also should be a faithful representation of the economic and other phenomena that it purports to represent in order to be useful in financial reporting. The depiction of the phenomena is faithfully represented when the depiction is complete, neutral, and free from material error. To be neutral, the information should not be presented with the intention of attaining a particular predetermined result.
30. The cost of fulfillment measurement basis presents the cost that an entity is expected to incur to fulfill its obligation. This measurement basis does not intend to attain a particular result, it simply provides information as to the costs to the entity. Although liabilities that arise from non-exchange transactions of a resource provider often are subject to uncertainty, estimates of these liabilities often can be estimated by management. Estimates by management should reflect the best available information. The terms of the arrangements are known to management and the costs to fulfill the related obligations generally are readily available. The inputs to determine the cost of fulfillment often are the best available information.
31. Generally, the market value basis provides neutral information when the markets are open, active and orderly. As the quality of market evidence diminishes, estimation techniques must be used. As the markets for non-exchange transactions of resource providers are less likely to open, active and orderly, the market values are less likely to be supported by market evidence.
32. Similarly, the cost of release measurement basis requires the entity to evaluate the cost at which the entity can obtain an immediate exit from the liability. In the case of a non-exchange transaction, immediate exit from the creditor may be the same as the cost of fulfillment to the recipient. If the entity can obtain immediate exit through transfer of the liability to a third party. If such a transfer is the most cost-efficient method of settlement, then the cost of release would provide faithful representation of the settlement of the liability.

Understandability

33. The Conceptual Framework describes understandability as “the quality of information that enables users to comprehend its meaning.” The Conceptual Framework also notes that financial reports should present information that responds to the needs and knowledge bases of users, who are assumed to have reasonable knowledge of the entity’s activities and the environment in which it operates.
34. Market value and the cost of release generally are understandable to users. However, when a user considers the environment in which an entity operates, a user may not expect the entity to settle its obligations that arise from non-exchange transactions through a market transaction or through transfer of liabilities to third parties. Users may expect that a public sector entity will settle its obligations by providing the resources or services promised in the related agreement. The cost of fulfillment measurement basis may provide information that is most understandable to users within this environment.

Timeliness

35. Timeliness is described in the Conceptual Framework as having information available for users before the capacity to be useful for accountability and decision-making purposes is lost. In the context of using market value for assets, the market value measurement basis is considered to be available quickly. The market value approach generally is considered to provide timely information. However, as described, the identification of an open, active, orderly market for non-exchange transactions of resource providers may be challenging and affect the timeliness of the related market information.
36. The cost of release also would provide timely information, if the cost of release is considered to be relevant. Information regarding the amount a third party would accept to transfer the liability should be available to the entity in a timely manner. If the information is not available timely, the option to transfer the liability may not be open to the entity.
37. The entity has access to the information needed to measure the cost of fulfillment. Because the information needed to determine the costs the entity will incur to settle the obligation is readily available to the entity, the cost of fulfillment measurement basis will provide timely information.

Comparability

38. Comparability is the quality of information that allows users to identify similarities in and differences between two sets of information. Information is more useful if users can compare information about an entity to information about the entity from other time periods or to information about other entities from the same time period.
39. Similar to the discussion above related to the characteristic of timeliness, market value information is generally considered to be comparable when the markets used are active, open and orderly. As the quality of market evidence declines, the comparability of the resulting measurement of liabilities also declines.
40. The cost of release will depend upon the terms of the agreement in which the public sector entity obtains an immediate exit from the obligation. Because such agreements are likely to be rare for public sector entities, there is likely to be a lack of comparability of the information that results from the use of the cost of release measurement basis. The terms of the arrangement with a third party may depend on factors that are not related to the specific transaction (for example, the credit worthiness of the resource provider) and therefore are likely to be unique and may not be replicated.
41. The cost of fulfillment also may depend upon the terms of agreements in which the entity incurs an obligation. Although the types of agreements and related terms may vary across time periods and entities, using the costs to fulfill those obligations results in a consistent approach to measuring the related liabilities.

Verifiability

42. The Conceptual Framework describes verifiability as the “quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent.” When market values are determined in open, active, and orderly markets, the information provided is verifiable through observation of the markets. As previously noted, when the markets are not open, active and orderly, as is likely the case with non-exchange transactions of resource providers, the information could be less verifiable.

43. The cost of release and cost of fulfillment both provide information that is verifiable. The terms of the arrangements to either immediately exit the obligation or to fulfill can be verified. Any inputs necessary to estimate the related costs also will be verifiable under either measurement basis. The determination of which measurement basis results in the most verifiable evidence will depend upon the evaluation of which basis is the most appropriate for the situation.

Summary

44. Through evaluation of the measurement basis options in the two examples above and consideration of the qualitative characteristics, the project staff recommends that the cost of fulfillment as the most appropriate measurement basis for non-exchange transactions of a resource provider. Project staff recommends the cost of fulfillment measurement basis be presented in the consultation paper for non-exchange transactions of resource providers.

Matter(s) for Consideration

1. The IPSASB is **asked** if it agrees with the recommendation to use cost of fulfillment as the measurement basis for non-exchange transactions of resource providers.

ISSUES PAPER, *NON-EXCHANGE EXPENSES* – *ALTERNATIVES***Introduction**

1. The objective of this paper is to discuss two potential alternatives for developing guidance for non-exchange expenses to be included in the Consultation Paper. The paper describes the two alternatives, including advantages and disadvantages of each alternative. Alternative 1 is to apply the guidance in International Public Sector Accounting Standard (IPSAS) 19, *Provisions, Contingent Liabilities and Contingent Assets* to non-exchange expenses that are not social benefits. Alternative 2 is to expand the scope of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, to non-exchange expenses.
2. This paper focuses on the alternatives for non-exchange expenses. For the Consultation Paper, the development of a performance obligation approach would be described as potential guidance for exchange transactions.

Alternative 1: IPSAS 19

3. In Alternative 1, the guidance in IPSAS 19 would apply to non-exchange expenses other than those related to social benefits. The scope of IPSAS 19 would be modified to specifically include those types of transactions. Alternative 1 provides certain advantages and disadvantages.

Advantages of Alternative 1

4. An advantage of Alternative 1 is that the guidance in IPSAS 19 provides preparers flexibility to address various jurisdictional situations. IPSAS 19 defines a constructive obligation as:

an obligation that derives from an entity's actions where (a) by an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
5. IPSAS 19 also states that decisions by an entity's management, government body, or controlling entity does not give rise to a constructive obligation unless those decisions have been communicated to those affected by the decision in a "sufficiently specific manner" that raises a valid expectation that the entity will discharge the related responsibilities.
6. By referencing an entity's past practice, policies, statements, and communication to affected parties, IPSAS 19 allows for each entity's specific situation to influence the recognition and reporting of liabilities, specifically those related to non-exchange transactions. For example, certain jurisdictions may communicate to citizens that relief from certain natural disasters will be provided that creates a valid expectation that the entity will discharge its responsibilities for that relief. Other jurisdictions may not have the same mechanisms for communication or may not have the prior history sufficient to raise expectations of its citizens. IPSAS 19 allows for judgment of the factors specific to each case to determine if a constructive obligation exists.

7. IPSAS 19 also allows for future events that may affect the amount required to settle an obligation to be reflected in the amount of a provision when there is sufficient objective evidence that the events will occur. This allows preparers to consider future changes in technology, legislation, or other factors as may be necessary for a particular transaction.

Disadvantages of Alternative 1

8. The primary criticism of IPSAS 19 is the lack of specificity in the standard, which provides little to no guidance on the accounting and reporting of non-exchange expenses. This lack of guidance leads to the potential for inconsistent application. Feedback from preparers indicated lack of consistency in the treatment of accruals for non-exchange expenses. With the lack of specific guidance provided by IPSAS 19, there is potential for different accounting and financial reporting to occur for similar transactions.
9. IPSAS 19 acknowledges that it may be unclear whether a present obligation exists. IPSAS 19 states that in such cases, a past event is evaluated and deemed to give rise to a present obligation if it is more likely than not that a present obligation exists at the reporting date. Preparers must exercise judgment to determine whether a present obligation is “more likely than not” to exist. Some interview respondents reported challenges in applying this judgment.
10. Since the issuance of IPSAS 19, both the Conceptual Framework and IPSAS 23 have been issued by the IPSASB. The Conceptual Framework defines the elements of financial statements, including liabilities. The Conceptual Framework defines a liability as a present obligation for an outflow of resources that results from a past event. It defines a present obligation as “a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid.” The Basis for Conclusions includes a discussion of the Board’s consideration of present obligations, including conditional and unconditional obligations, stand-ready obligations, and performance obligations. The Conceptual Framework concluded that consideration of these concepts would be a standards-level issue, not an issue to be decided by the Conceptual Framework. Some believe that the guidance in IPSAS 19 is not sufficiently specific to consider these obligations.

Matter(s) for Consideration

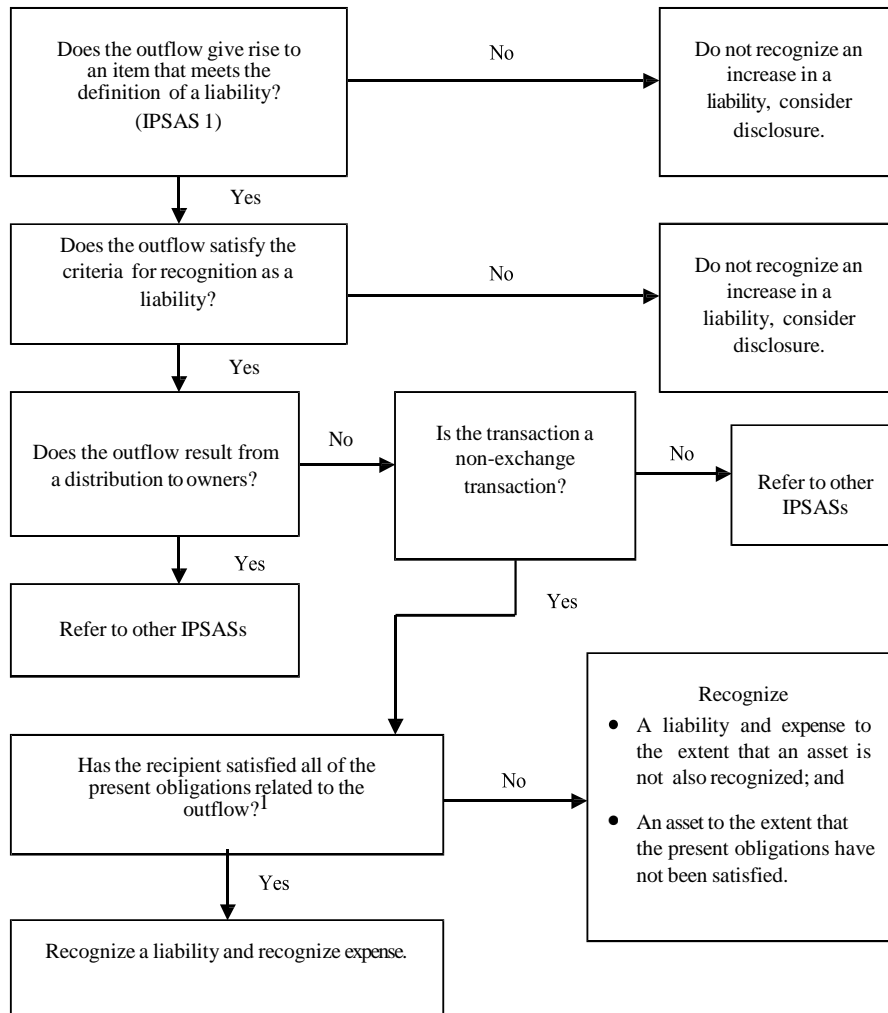
1. The IPSASB is **asked** if it agrees with the advantages and disadvantages of Alternative 1.
2. The IPSASB is **asked** if it agrees that Alternative 1 should be presented in the Consultation Paper.

Alternative 2: Expand IPSAS 23

11. Alternative 2 for the treatment of non-exchange transactions of resource providers that are not social benefits is to develop a modified IPSAS 23 approach for non-exchange transactions of resource providers. IPSAS 23 requires recipients to evaluate an inflow of resources to determine if the inflow is an asset. A series of decisions are then made to determine if there is a liability or if the asset has created revenue to the recipient. A similar series of decisions could be applied to a potential outflow of resources. The decision steps from IPSAS 23 could be modified for evaluation of an outflow as follows:
 - Does the outflow give rise to an item that meets the definition of a liability?
 - Does the outflow satisfy the criteria for recognition as a liability?
 - Is the outflow a distribution to owners?

- Is the transaction a non-exchange transaction?
 - Has the recipient satisfied all of the present obligations related to the outflow?
12. As described above, the Conceptual Framework provides the definition of a liability, which is the starting point for the analysis described in this alternative. The following decision tree is adapted from IPSAS 23 to show the application of the steps described.

Figure 1 – IPSAS 23 Illustration of the Analysis of Initial Outflows of Resources



1. In determining whether the recipient has satisfied all of the present obligations, the application of the definition of conditions on a transferred asset, and the criteria for recognizing a liability, are considered.

Advantages of Alternative 2

13. One advantage of Alternative 2 is that preparers are generally familiar with the existing provisions of IPSAS 23 in regards to revenue transactions. Feedback provided by preparers interviewed indicated that the concepts described in IPSAS 23 have been used to evaluate the recording and reporting of non-exchange transactions of a resource provider. Using IPSAS 23 as a basis for a standard on non-exchange transactions of resource providers could result in fewer implementation difficulties as preparers are familiar with the provisions that would be included in such a standard.

14. As noted, at times certain transactions may be difficult to classify as purely exchange or purely non-exchange. IPSAS 23 includes some guidance on accounting for transactions with both exchange and non-exchange components. IPSAS 23 guides entities to attempt to determine the portion of a transaction that is exchange and the portion that is non-exchange. If the determination cannot be made, the transaction is considered to be a non-exchange transaction. Similar guidance would be useful in the accounting for and reporting of non-exchange transactions of resource providers.

Disadvantages of Alternative 2

15. A potential disadvantage to developing guidance for the non-exchange transactions of resource providers based on the current IPSAS 23 approach is that if IPSAS 23 does not provide adequate guidance for non-exchange revenue, a mirror image of the standard may not provide sufficient guidance for resource providers. However, modifications to IPSAS 23 could also be considered for the treatment of non-exchange expenses. Modifications to IPSAS 23 to consider feedback have not been fully explored.
16. One issue noted by preparers relates to the treatment of stipulations. Preparers reported that while IPSAS 23 provides definitions of both conditions and restrictions, identifying the difference between conditions and restrictions has been difficult in practice. Some agreements may specify that funds are to be used in a particular manner, while others imply a multi-year arrangement. However, the terms of the agreement do not specifically require a refund if the stipulations are not met (however, the preparers note that it is clear to all parties that the stipulations will be met). Because the terms of the agreement are not sufficiently specific to be treated as a condition, the revenue is recorded at the beginning of the agreement rather than as the resources are used as specified in the agreement.
17. Feedback from preparers also indicated that the current threshold for a stipulation to be considered a condition is so high that it is rare to recognize a liability for a non-exchange transaction. This leads to recognition of revenue in cases where preparers believe that this is not a faithful representation of the transaction. This situation would need to be considered in guidance for transactions of resource providers as well. If not addressed, resource providers may be required to recognize expense on an accelerated basis compared to current practice.
18. In addition, the difference in recording inflows with restrictions from recording inflows with conditions has resulted in inflows being recognized as revenue at the beginning of a multi-year arrangement when the timing requirements of the agreement are not specifically linked to a refunding provision (however, the preparers note that it is clear to all parties that the timing requirements will be met). Therefore, even though there is an implication that the funds are to be used over the term of the agreement, revenue is generally recognized at the beginning of the agreement.
19. Many interviewees also reported a similar issue for the recognition of revenue from capital grants. These arrangements, absent conditions, were recorded as revenue in the year in which the agreement became binding unless the agreement included conditions on the use of the asset. If conditions on the ongoing use of the asset were also included in the agreement, practice has varied. Some jurisdictions have recorded revenue as the conditions regarding ongoing use were met, or as the related asset was depreciated. In situations where the grant agreements did not include conditions on the use of assets, and revenue was recognized when the agreement was binding, related outflows for the construction of the capital asset may have occurred over several years. Preparers have noted that this pattern of recognition does not result in a faithful representation of the entity's annual results.

20. Again, to use the same guidance for a resource provider may cause similar results in the financial statements. Resource providers may be required to recognize expenses earlier than required by current guidance if similar provisions are required in specific guidance for non-exchange transactions of resource providers. The issue also would need to be considered for effects on symmetry of accounting between public sector entities.
21. Another potential challenge to using the IPSAS 23 approach is the correct starting point at which to evaluate a potential liability to a resource provider. IPSAS 23 requires recipients to evaluate an inflow to determine if that inflow meets the definition of an asset. For certain public sector entities, the point at which to evaluate an outflow may be difficult to identify.
22. The Conceptual Framework notes that the complexity of public sector programs and activities means that a number of events may give rise to obligations. For financial reporting purposes, it is necessary to identify which of these obligations are binding obligations that the entity has little or no realistic alternative to avoid and satisfy the definition of a liability. At what point does a liability arise for resource providers? Identification of this point is critical to determine when to apply any resulting guidance.
23. The social benefits CP includes several potential approaches to recognizing social benefit transactions. One of the approaches considered in that CP is the obligating events approach, which has five sub-options. Many of the sub-options are intended to address the satisfaction of eligibility requirements by recipients. This approach may be useful in developing guidance for non-exchange transactions that are not social benefits. Many of the programs in which resources are provided to individuals and households, and even other entities, that are not social benefits include eligibility requirements that must be met before resources are provided. Therefore, the same analysis could be applied to these transactions as the analysis applied to social benefit transactions.
24. Not all non-exchange transactions of a resource provider include eligibility requirements. These transactions may not be as easily addressed by the sub-options in the social benefits CP; however, the approach to evaluating an obligating event may still be useful.
25. Finally, applying the IPSAS 23 approach may have unintended consequences. Additional complications may arise when applying the standard, in mirror image, to transactions from a different viewpoint. The viewpoints of resource providers are completely opposite of the viewpoints of resource recipients, so the approach will need to be carefully considered. Even with the consideration, there may be some transactions that have not been identified for which the approach will not be appropriate or will pose additional challenges.

Matter(s) for Consideration
<ol style="list-style-type: none">3. The IPSASB is asked if it agrees with the expansion of IPSAS 23 to expenses as described.4. The IPSASB is asked if it agrees with the advantages and disadvantages of Alternative 2.5. The IPSASB is asked if it agrees that Alternative 2 should be presented in the Consultation Paper.

Summary of Alternatives

26. The following Figure 2 summarizes the alternatives described in this paper, including the advantages and disadvantages:

Figure 2 – Summary of Alternatives

<i>Description</i>	<i>Advantages</i>	<i>Disadvantages</i>
<p>Alternative 1</p> <p>Continue to apply guidance in IPSAS 19 for non-exchange expenses</p>	<ul style="list-style-type: none"> • Flexible • Considers future events 	<ul style="list-style-type: none"> • Lack of specificity results in inconsistent application • Judgment required to identify present obligation and apply “more likely than not” threshold
<p>Alternative 2</p> <p>Expand the scope of IPSAS 23 to include non-exchange expenses</p>	<ul style="list-style-type: none"> • Familiar with IPSAS 23 requirements for resources received • Includes guidance on transactions that include both exchange and non-exchange components 	<ul style="list-style-type: none"> • Classification difficulty remains • Continues issues noted with application of IPSAS 23 • Treatment of stipulations may be problematic • Identification of correct starting point to identify transactions • Unintended consequences

Revenue and Non-Exchange Expenses

Chapter 1: Introduction

- History and scope of the projects
- Conceptual Framework
- New private sector recognition model
- Interaction with social benefits
- Approach of this CP

Chapter 2: Performance Obligation Approach

- Introduction
- Definition of performance obligation in the public sector
 - Definition in IFRS literature
 - Potential modifications to address public sector characteristics
 - Contracts
 - Transactions with three parties
 - Transfer of control
- Guidance for transactions without performance obligations
- Advantages and disadvantages
- Factors to consider
 - Conditions and restrictions
 - Appropriations and form of government

Chapter 3: Exchange/Non-Exchange Classification Approach

- Introduction
- Advantages and disadvantages of the overall approach
- Revenue alternatives
- Expense alternatives
- Factors to consider
 - Conditions and restrictions
 - Appropriations and form of government
 - Interaction with social benefits

Chapter 4: IPSAS 23 Alternatives

Chapter 5: Measurement

Appendix A: Overview of Existing IPSASs

Appendix B: Interviews

Appendix C: Decision Trees

- Depict each approach with alternatives

1 Introduction

- 1.1 Since its inception, the IPSASB has developed a number of standards that address the accounting for a wide range of transactions and events, and that acknowledge the characteristics of public sector entities. Through its ongoing work program the IPSASB aims to improve its standards and develop guidance on topics not currently addressed at a standards level. This Consultation Paper seeks feedback on two related matters: possible improvements to the accounting for revenue (both exchange and non-exchange) and potential guidance for the accounting for non-exchange expenses. Both of these topics require consideration of the characteristics public sector entities, particularly as the non-exchange expense of one public sector entity may give rise to revenue of another public sector entity.
- 1.2 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. To evaluate the performance of such entities, users need information regarding the financial position, financial performance, and cash flows of an entity, as well as information regarding the following:
- 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.
- 1.3 Public sector entities raise or obtain funds through a variety of methods, including taxation, transfers from other public sector entities, and charges for goods and services provided. Public sector entities use the resources obtained to provide services to the public through different types of transactions. Some public sector entities provide services directly to citizens, while others may contract with other entities to provide services on behalf of the public sector entity that initially receives the resources. Public sector entities provide resources to other public sector entities through transfers, grants, and other arrangements.
- 1.4 Currently, International Public Sector Accounting Standards (IPSASs) differentiate in certain circumstances between exchange transactions and non-exchange transactions. Current literature includes the following definitions for those transactions:

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.

- 1.5 Existing IPSASs provide guidance on a range of revenue transactions. The three main standards providing guidance for revenue transactions are:
- IPSAS 9, *Revenue from Exchange Transactions*;
 - IPSAS 11, *Construction Contracts*; and
 - IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.
- 1.6 A number of IPSASs provide guidance on the recognition of expenses and liabilities but there is currently very little guidance on the recognition of expenses and liabilities arising from non-exchange transactions. Although IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* was the result of a convergence project and was not specifically developed with non-exchange transactions in mind, it has been used by some as a source of guidance for the recognition of provisions for non-exchange transactions. At the time that IPSAS 19 was developed, the IPSASB decided to exclude social benefits from its scope. The IPSASB now has a project underway to develop guidance for social benefits provided by public sector entities. However, a gap exists for transactions that are not within the scope of either the existing guidance for exchange expenses or potential guidance related to social benefits.
- 1.7 There are a number of reasons why the IPSASB considers that this is an appropriate time to seek feedback from constituents on accounting for revenue and non-exchange expenses. Constituents have identified some difficulties in understanding the interaction between IPSAS 23 and other IPSASs when transactions have both exchange and non-exchange elements and have expressed concerns that the application of IPSAS 23 to certain transactions may not appropriately reflect the substance of those transactions. In addition, the International Accounting Standards Board (IASB) has recently issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*, which will replace International Accounting Standard (IAS) 11, *Construction Contracts* and IAS 18, *Revenues*. The performance obligation approach used in IFRS 15 represents new thinking for the recognition of revenue in the private sector and provides an opportunity to reexamine the IPSASs dealing with revenue.
- 1.8 This Consultation Paper (CP) is an important step in improving guidance for public sector entities for the appropriate reporting of revenues and expenses. The CP builds on current IPSASB guidance and considers new thinking related to performance obligations. The CP describes two potential approaches to the recognition of revenues and expenses of public sector entities. The objective of the CP is to initiate a debate about matters such as:
- scope of potential guidance related to revenues and expenses;
 - approaches to recognition of revenues of public sector entities;
 - approaches to recognition of expenses of public sector entities that are not specifically addressed in other standards; and
 - symmetry of accounting between resource providers and resource recipients.

History and Scope of the Projects

- 1.9 In March 2015, the IPSASB approved project briefs on Revenue and Non-Exchange Expenses. The revenue project brief proposed a single revenue project to update the IPSASB's requirements and guidance on exchange and non-exchange revenue. The project would lead to one or more new standards that would replace IPSAS 9, IPSAS 11, and IPSAS 23. IPSAS 9 and IPSAS 11 were developed as part of the IPSASB's first phase of work to develop a core set of IPSASs based, to the extent appropriate, on IASs. These were referred to as convergence projects and IPSAS 9 and IPSAS 11 were drawn primarily from IAS 18 and IAS 11, respectively. By contrast, IPSAS 23 was developed from first principles to address public sector specific issues. Although the current revenue project is not intended to be a convergence project, the approach described in IFRS 15 is one of the major approaches considered throughout the revenue project and presented in this CP. Additional background on the development of IPSASs 9, 11, and 23, as well an overview of key provisions of these IPSASs, is provided in Appendix A to this CP.
- 1.10 Current guidance for certain expenses, including non-exchange transactions, is presented in IPSAS 19. IPSAS 19 was developed as a convergence project and was drawn primarily from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
- 1.11 IPSAS 19 specifically excludes provisions and contingent liabilities arising from social benefits from its scope. This scope exclusion has meant that IPSASs have not addressed accounting for social benefits. In order to address the accounting and financial reporting of social benefit programs the IPSASB has initiated a project on that topic and issued a Consultation Paper, *Recognition and Measurement of Social Benefits*, in 2015. The social benefits CP seeks feedback on issues associated with accounting for social benefits, which are non-exchange transactions; however, it does not address all non-exchange transactions in which public sector entities provide resources. Although IPSAS 19 can be regarded as a source of guidance on accounting for non-exchange transactions other than social benefits, neither IPSAS 19, nor other IPSASs, specifically address such transactions.
- 1.12 During the development of the revenue project and the original non-exchange expense project, the IPSASB noted that there was significant overlap in the issues being considered in both projects and a need to consider the development of standards level guidance for both projects at the same time. Public sector entities often provide resources to other public sector entities; therefore, transactions giving rise to revenue for one public sector entity may also give rise to an expense for another public sector entity. Examples of such transactions between public sector entities include primarily transfers and grants, but also may include taxes, fines, fees, and penalties.
- 1.13 Throughout development of the projects, similar issues arose in the consideration of approaches that may address either revenue or expense transactions. The repetition of options presented highlighted the overlap of transactions in the projects, as well as the potential for transactions of resource providers that were not initially considered in the scope of a non-exchange expenses project to be addressed in potential guidance. The overlap also highlighted that the transactions that generate revenue for one public sector entity in many cases are an expense for another public sector entity. The IPSASB agreed that symmetry in the accounting by resource providers and resource recipients also should be considered in developing accounting and financial reporting alternatives.
- 1.14 During the IPSASB's deliberations on the potential application of the performance obligation approach, it became clear that performance obligations may exist in both exchange and non-

exchange transactions (using current terminology). Using current terminology the transactions of resource providers could be classified along a continuum, ranging from pure exchange transactions to pure non-exchange transactions, such as social benefit schemes. The IPSASB noted that, in addition to the lack of guidance on non-exchange transactions, there may also be some gaps in its literature in respect of transactions in the middle of this continuum. Therefore, the scope of the non-exchange expenses project was expanded to include transactions that may not be classified as non-exchange, but nonetheless need to be addressed.

- 1.15 To evaluate the effects of any approach to the recognition of revenue by resource recipients and expense by resource providers in the public sector, one must consider the effects on both parties to the transaction. To fully grasp the ramifications of a particular approach, the IPSASB agreed that a single consultation paper should be presented that describes the effects of the recognition approaches for both side of a transaction—that is, the recognition of revenue by a recipient and the corresponding recognition of expense by a resource provider.
- 1.16 Two approaches to recognition have been explored throughout the projects and are presented in this CP: (1) the performance obligation approach and (2) the exchange/non-exchange classification approach.

Feedback from Preparers and Users

[DRAFTING NOTE: If additional interviews with users are not conducted, references to user interviews and feedback will be removed.]

- 1.17 In order to obtain feedback from constituents regarding the specific issues to be addressed within the revenues and non-exchange expenses projects, the IPSASB interviewed preparers and users of public sector financial statements. 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 projects. Separate interview protocols were developed for preparers and for users.
- 1.18 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 related to which public sector entities to contact. Members also provided contact information for representatives of the public sector entities.
- 1.19 Efforts were made to select interview participants that prepare financial statements for different sizes and types of entities; however, the participants were not select using a random process, nor were the findings analyzed using statistical techniques. A relatively small number of participants were interviewed. Consequently, while the information from the interviews may represent some views that exist in the larger population of preparers, the results are not generalizable and may not represent all views in the population.
- 1.20 Preparers were asked to share their experiences of accounting for non-exchange revenue and expenses, including transactions with timing and purpose restrictions. Preparers described practical issues in the application of IPSAS 23, specifically related to the treatment of stipulations and the timing of recognition for multi-year agreements. Preparers also described difficulty in classifying transactions as exchange or non-exchange. While preparers noted these difficulties, the preparers did not indicate disagreement with the conceptual basis of the guidance regarding non-exchange transactions. Additional details of the results of the preparer interviews are included as Appendix B to this CP and are referenced throughout the remaining Chapters of this CP.

Conceptual Framework

- 1.21 The Conceptual Framework establishes the objectives and qualitative characteristics of financial reporting, which provides a framework against which various approaches described in this CP are evaluated.
- 1.22 The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial reports for accountability purposes or decision-making purposes. The results of any final guidance related to the provision of exchange and non-exchange transactions may be relevant to meeting a variety of information needs of service recipients and resource providers, including assessing an entity's:
- Performance during the reporting period;
 - Liquidity and solvency;
 - Ability to sustain the services it delivers and other operations over the long term; and
 - Capacity to adapt to changing circumstances.
- 1.23 Information from the proper reporting of revenues and expenses is essential to assessing accountability. As described in the Conceptual Framework, public sector entities are accountable to both those who provide resources to the public sector entity and those that depend on the public sector entity to use those resources to deliver services during the reporting period and over the longer term. Public sector entities must demonstrate accountability for the management of resources entrusted to them for the delivery of services.
- 1.24 Information about revenues and expenses also supports decision making. Information about costs and resources available to support activities will be useful to donors and other financial supporters in the determination of resources provided to the entity.
- 1.25 The Conceptual Framework introduced updated definitions of the elements in financial statements, including assets, liabilities, revenues and expenses. These definitions have influenced the IPSASB's consideration of when revenue and expenses should be recognized for non-exchange transactions. When one views the basic provision of non-exchange transactions, the recognition of expense by the resource provider automatically comes to mind, thus the name of the non-exchange expenses project. However, if a resource is provided in advance, an asset could result. Moreover, in certain circumstances, based on discussion in the basis for conclusions of the elements portion of the Conceptual Framework, accepting that certain economic phenomena that do not meet the definition of any element may not provide all the information in the financial statements that is necessary to meet users' needs, the use of an additional item may be necessary.
- 1.26 The Conceptual Framework describes factors that should be considered when developing standards-level guidance on measurement. It states that the objective of measurement is:
- "To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes."
- 1.27 Selection of measurement bases also includes an evaluation of the extent to which a measurement basis provides information that achieves qualitative characteristics while considering the constraints on information in financial reports. The Conceptual Framework proposes that no single measurement basis will best meet the measurement objective. Instead, the Conceptual Framework describes

multiple potential measurement bases for assets and liabilities and provides guidance on the selection of a measurement basis. The information provided by each basis identified in the Conceptual Framework is discussed in terms of the information provided about the cost of services, operational capacity, and financial capacity of the entity, as well as the qualitative characteristics. The measurement basis selected for assets and liabilities will be discussed in Chapter 5 of this CP.

New Private Sector Recognition Model

- 1.28 The IASB issued IFRS 15 in May 2014. The IASB initiated its project to clarify the principles for recognizing revenue. 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 should reflect the transfer of control of the asset to the customer and the amount of revenue recognized should be equal to the consideration the entity is entitled to for satisfying the performance obligation. IFRS 15 will replace the current guidance in IAS 11 and IAS 18, which were primary sources for current IPSASB guidance.
- 1.29 The performance obligation model described in IFRS 15 is used as a key reference point for the development of the performance obligation approach described in Chapter 2.

Interaction with Social Benefits

- 1.30 The transactions within the scope of this CP will depend upon the options selected, except for transactions that are within the scope of potential social benefits guidance. If this project takes a broad approach, then exchange transactions with performance obligations would be within scope, as well as non-exchange transactions. Exchange transactions that do not have performance obligations are not included. If the project takes a narrow approach, only non-exchange expenses are included within the scope. Exchange expenses would be excluded. In either approach, transactions that are within the scope of potential social benefits guidance would not be included in the scope of this project.
- 1.31 This CP draws on the Conceptual Framework, existing IPSASB guidance, feedback from preparers and users, and the performance obligation recognition model from the IASB to consider two approaches to the recognition of revenues and expenses by public sector entities. The CP first describes the following two options for the overall approach to recognition:
- Performance Obligation Approach; and
 - Exchange/Non-exchange Classification Approach.
- 1.32 These approaches are explored in Chapters 2-3, including discussion of alternatives to each approach. Chapter 4 describes alternatives to modify IPSAS 23 and Chapter 5 describes measurement. Appendix C to the CP presents decision trees for the two approaches described.

Appendix A: Overview of Existing IPSASs

A.1 This Appendix provides an overview of the existing IPSASs that provide guidance for revenue and expenses.

IPSAS 9

A.2 IPSAS 9 provides guidance for the recognition of revenue from exchange transactions and requires public sector entities to identify the existence of transactions that involve the rendering of services, sale of goods, or use of entity assets yielding interest, royalties and dividends or similar distributions. Recognition of revenue through exchange transactions is based on a risks and rewards model, but the Standard does refer to the transfer of control over goods. Revenue from the sale of goods in an exchange transaction is recognized when the risks and rewards of the goods are transferred. Revenue from providing services in an exchange transaction is recognized based on the percentage of completion of the services.

A.3 IPSAS 9 was drawn primarily from IAS 18. The comparison between IPSAS 9 and IAS 18 notes the main differences between the two standards. It states:

- The title of IPSAS 9 differs from that of IAS 18, and this difference clarifies that IPSAS 9 does not deal with revenue from non-exchange transactions.
- The definition of “revenue” adopted in IPSAS 9 is similar to the definition adopted in IAS 18. The main difference is that the definition in IAS 18 refers to ordinary activities.
- Commentary additional to that in IAS 18 has also been included in IPSAS 9 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 9 uses different terminology, in certain instances, from IAS 18. The most significant example is the use of the term “net assets/equity” in IPSAS 9. The equivalent term in IAS 18 is “equity.”

IPSAS 11

A.4 IPSAS 11 provides guidance for the recognition of revenue from construction contracts. IPSAS 11 uses the existence of a construction contract as the starting point for determining revenue recognition and again uses a risks and rewards model. If the outcome of a contract can be reliably measured, revenue is recognized based on the percentage of completion of the construction. If the outcome is uncertain, revenue is recognized to the extent that costs are recoverable.

A.5 IPSAS 11 was drawn primarily from IAS 11. The comparison between IPSAS 11 and IAS 11 notes the main differences between the two standards. It states:

- Commentary additional to that in IAS 11 has been included in IPSAS 11 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 11 uses different terminology, in certain instances, from IAS 11. The most significant examples are the use of the terms “revenue,” and “statement of financial performance” in IPSAS 11. The equivalent terms in IAS 11 are “income,” and “income statement.”
- IPSAS 11 includes binding arrangements that do not take the form of a legal contract within the scope of the Standard.
- IPSAS 11 includes cost-based and noncommercial contracts within the scope of the Standard.
- IPSAS 11 makes it clear that the requirement to recognize an expected deficit on a contract immediately it becomes probable that contract costs will exceed total contract revenues applies only to contracts in

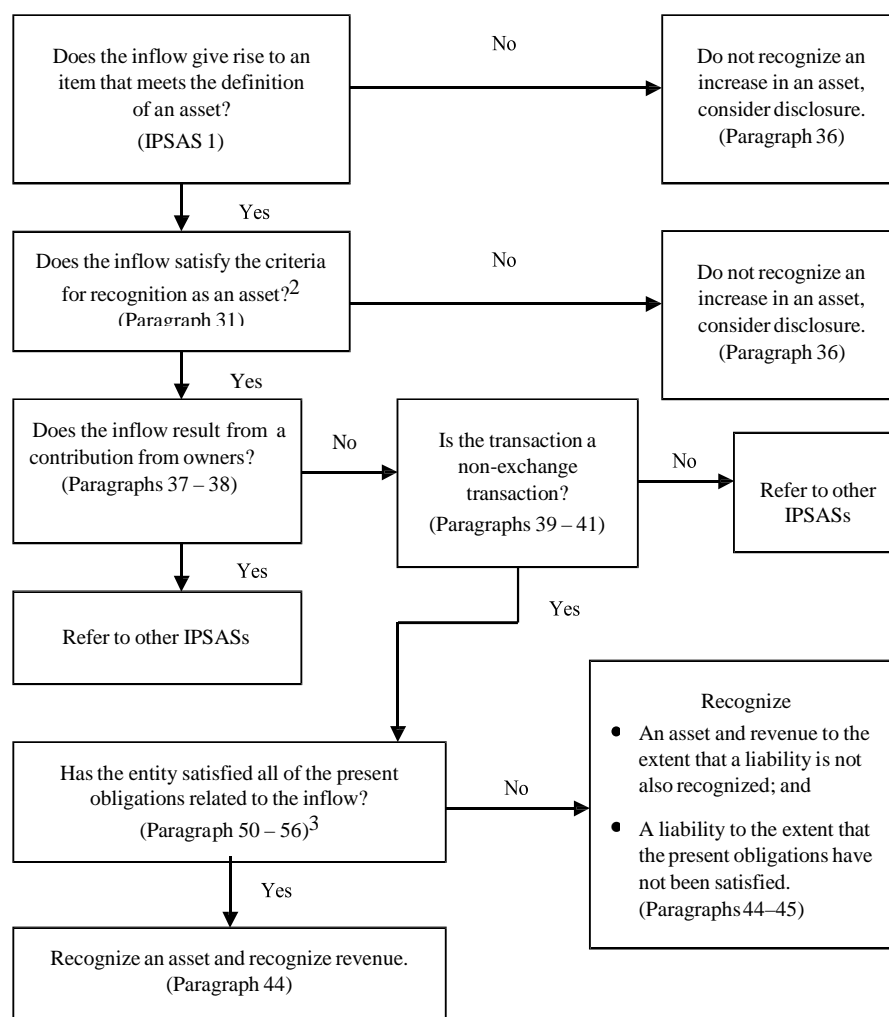
which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to that contract.

- IPSAS 11 includes additional examples to illustrate the application of the Standard to noncommercial construction contracts.

IPSAS 23

- A.6 IPSAS 23 resulted from a project that began in 2002. The IPSAS (then the Public Sector Committee) initiated a project to develop guidance for the recognition and measurement of revenue from non-exchange transactions. An Invitation to Comment (ITC) was published in January 2004 and Exposure Draft (ED) 29 was published in January 2006. In November 2006, the IPSASB approved IPSAS 23 for issuance. During development of the Standard, the IPSASB considered views expressed in the comment letters as well as views of the Steering Committee to develop a broad, principles-based approach to guidance for revenue from non-exchange transactions.
- A.7 IPSAS 23 provides guidance for the recognition of revenue from non-exchange transactions, including taxes and transfers. IPSAS 23 requires entities to use the existence of a right to an asset which may give rise to revenue as the starting point to evaluate the transaction. IPSAS 23 relies on the transfer of control of the asset rather than a risks and rewards model. If the entity controls the asset as a result of a non-exchange transaction, the entity recognizes an asset. The entity then determines if the resulting inflow from such assets is a contribution from owners. If the inflow is not a contribution, the entity then evaluates the existence of any present obligations related to the inflow. If a present obligation exists and meets the definition of a liability, a liability is recognized. Revenue is recognized to the extent that an asset is recognized and any present obligation is satisfied. IPSAS 23 includes a non-authoritative flow chart to assist in the evaluation of inflows of resources, as shown in Figure 1.

Figure 1 – IPSAS 23 Illustration of the Analysis of Initial Inflows of Resources



1. The flowchart is illustrative only, it does not take the place of this Standard. It is provided as an aid to interpreting this Standard.

2. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability.

3. In determining whether the entity has satisfied all of the present obligations, the application of the definition of conditions on a transferred asset, and the criteria for recognizing a liability, are considered.

IPSAS 19 and Guidance for Specific Expenses

A.8 While IPSAS 19 was not developed with non-exchange transactions in mind, it has been used as a source of guidance in IPSASs for accounting for provisions related to non-exchange expenses that are not social benefits. IPSAS 19 defines contingent assets, provisions, and contingent liabilities, and identifies how these transactions and other events should be recognized and measured. It also provides disclosure requirements related to those transactions. The Standard distinguishes between provisions, which are recognized as liabilities, and contingent liabilities, which are not recognized. IPSAS 19 explains that all provisions are distinct from other liabilities such as payables and accruals because the timing or amount of future expenditure required to settle a provision is uncertain.

- A.9 A provision is recognized when (1) an entity has a present obligation (legal or constructive) as a result of a past event; (2) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (3) a reliable estimate can be made of the amount of the obligation. In considering what is a present obligation, paragraph 51 of IPSAS 23 adds that a present obligation is a “duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts.”
- A.10 IPSAS 19 acknowledges that, in some circumstances, it may be unclear whether a present obligation exists. In those cases, a past event (obligating event) is considered to give rise to a present obligation if it is more likely than not that a present obligation exists at the reporting date. If the more likely than not threshold is not met, the entity discloses a contingent liability unless the possibility of a resource outflow is remote.
- A.11 For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only where the settlement of the obligation (a) can be enforced by law, or (b) the event creates valid expectations in other parties that the entity will discharge the obligation (as is the case for a constructive obligation).
- A.12 The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the reporting date. This is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. In circumstances where the effect of the time value of money is material, the amount of the provision that is recognized should be the present value of the expenditures expected to be required to settle the obligation. IPSAS 19 allows entities to consider the impact of future events—such as the effect of possible new legislation, inflation, or technological developments—on the amount of the liability that is recognized.
- A.13 Current IPSASB literature contains guidance relevant to the recognition and measurement of expenses in several standards. In addition to IPSAS 19, the following standards provide guidance on the recognition of certain expenses:
- IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*;
 - IPSAS 12, *Inventories*;
 - IPSAS 13, *Leases*;
 - IPSAS 17, *Property, Plant and Equipment*; and
 - IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Appendix B: Interviews

Preparer Interviews

- B.1 The objectives of the outreach to preparers of public sector financial statements were to obtain feedback regarding how the standards have worked in practice and to identify any issues that the IPSASB may need to address in the revenue and non-exchange expenses projects.
- B.2 Preparers were asked to identify the types of non-exchange revenues and expenses that exist for the respondent's jurisdiction. Preparers were then asked to identify any difficulties encountered with recognition, measurement, or disclosure of those non-exchange revenues and expenses. Participants noted the following difficulties relevant to non-exchange revenues:
- determining whether stipulations are conditions or restrictions;
 - timing of recognition, especially for multi-year pledges received at the beginning of the arrangement;
 - recording pass-through transactions;
 - reporting in-kind services;
 - assessing probability of collection at initial recognition versus subsequent measurement;
 - reporting related to financing of construction projects; and
 - distinguishing between exchange and non-exchange transactions at an operational level.
- B.3 Some participants noted no issues or difficulties relevant to non-exchange expenses. Participants who identified difficulties relevant to non-exchange expenses noted the following issues:
- recording expenses over multiple years, including contributions and forbearance loans;
 - applying the "more likely than not" threshold from IPSAS 19 in practice;
 - defining an onerous contract;
 - measuring the expense;
 - accounting for concessionary, forbearance, and conditional loans; and
 - recording fiscal equalization payments based on statistical predictions.
- B.4 Preparers also were 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 by some respondents, responses to this specific question 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 licenses, classifying the transaction as either a fee for service or a tax was challenging.
- B.5 The outreach 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.

- B.6 When asked if non-exchange expenses currently required the recording of accruals, respondents reported 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. 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.
- B.7 Respondents also reported a wide range of guidance that had been consulted when the respondents were considering the recording or reporting of these non-exchange expenses. Among the answers were IPSASB guidance, IASB guidance, consultation with auditors or accounting firms, and commercial law or accounting guidance of a standard setting group within their entity's jurisdiction.
- B.8 The outreach also sought to understand how prevalent the occurrence of stipulations, specifically time or purpose restrictions, were imposed on the non-exchange revenues or expenses of the entities. With regard to non-exchange revenues, many respondents indicated that they received resources with time or purpose restrictions. 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.
- B.9 Interview participants generally noted challenges in accounting for and reporting non-exchange revenues that were received in advance for multiple years of funding. Some recipients also noted that accounting for stipulations caused challenges. While some respondents indicated that certain transactions, such as licenses and fees, were difficult to classify as exchange or non-exchange revenue, many respondents did not indicate concern with the conceptual distinction.
- B.10 Interview participants generally did not indicate significant issues with the accounting for or reporting of non-exchange expenses. Some participants 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.

[DRAFTING NOTE: Without additional user feedback, this section will need to be removed.]

User Interviews

- B.11 The objective of the outreach to users of public sector financial statements, both for the revenues 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.