

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** New York, USA

**Meeting Date:** March 8-11, 2016

## Agenda Item 12

For:

☐ Approval

☒ Discussion

☒ Information

### Revenue

#### Objectives of Agenda Item

1. The overall objective of this item is to feedback from the IPSASB on the possible extension of the performance obligation approach in IFRS 15, *Revenue from Contracts with Customers*, to a broader range of revenue transactions. The paper responds to the IPSASB's request to do more thinking about some of the transactions referred to as Category B transactions in the December 2015 agenda papers (refer agenda paper 8.4, December 2015). The paper explores ideas rather than coming to conclusions.
2. The IPSASB's views will influence the drafting of Chapter 3 in the Consultation Paper (refer agenda item 11).
3. Staff are also seeking feedback about the work required for the June meeting.

#### Materials Presented

Agenda Item 12.1      Issues Paper

#### Action Requested

4. The IPSASB is asked to provide feedback on the Matters for Consideration in Agenda Paper 12.1.

## **REVENUE**

### **Extending IFRS 15 to a Broader Range of Performance Obligations**

#### **Objectives of the Issues Paper**

1. The objective of this issues paper is to consider how the revenue recognition model in IFRS 15 *Revenue from Contracts with Customers* could be modified to apply to a broader set of transactions than envisaged by IFRS 15 and whether extending IFRS 15 in this way would be appropriate. The paper responds to the IPSASB's request to do more thinking about some of the transactions referred to as Category B transactions in the December 2015 agenda papers (refer agenda paper 8.4, December 2015).<sup>1</sup>
2. The paper explores ideas rather than coming to conclusions. However, the IPSASB will need to form views, or at least identify specific proposals on which it wants feedback, in order for staff to draft the relevant sections of the Consultation Paper.

#### **Background**

3. During 2015 the IPSASB considered possible approaches to revising its revenue standards<sup>2</sup> and developing a standard on non-exchange expenses. Because of the overlap between the revenue project and the non-exchange expenses project, the agenda papers for December were presented as a combined item.
4. One of the key issues has been deciding the extent to which the revenue recognition model in IFRS 15, which is based around the satisfaction of performance obligations in a commercial context, could be appropriate for a broader set of public sector revenue transactions. This has implications for the scope of new and revised revenue standards and also for the non-exchange expenses project. It would also affect the proposals put forward by the IPSASB in the Consultation Paper that is being drafted for these projects.
5. The contents of the December 2015 agenda papers and feedback from the IPSASB are set out in Table 1 below.

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<sup>1</sup> For the purpose of Board discussions on this issues paper, we have continued to use the term Category B to refer to a range of revenue transactions in the middle of a spectrum of transactions ranging from transactions with specific performance obligations to those with no performance obligations. However, we would not propose to use that term in the Consultation Paper.

<sup>2</sup> IPSAS 9, *Revenue from Exchange Transactions*, IPSAS 11, *Construction Contracts* and IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

**Table 1 IPSASB's December 2015 agenda papers**

IPSASB Agenda Item	Feedback from IPSASB in December
<p><b>8.1 Interviews of Preparers</b></p> <p>Summary of outreach interviews conducted with preparers of financial statements regarding issues encountered using the existing guidance for non-exchange transactions.</p> <p>There were no real surprises here. Most of these issues have previously been raised with the IPSASB.</p> <p>It has been difficult to arrange interviews with users.</p>	<p>The IPSASB noted this feedback. It will inform the future work on these projects (e.g. in improving IPSAS 23).</p>
<p><b>8.2 Landscape Review – Expenses</b></p> <p>Summarised existing guidance for expenses in IPSASs.</p> <p>A similar summary of guidance in existing IPSASs for non-exchange revenue was presented to the IPSASB in September 2015.</p>	<p>Noted.</p>
<p><b>8.3 Exchange/Non-Exchange Classification Approach</b></p> <p>This Issues Paper outlined the non-exchange/exchange classification approach currently used in IPSASs. It looked at the advantages and disadvantages of the exchange/ non-exchange approach, as well as potential modifications to that approach.</p> <p>The paper discussed two alternatives for non-exchange expenses: (i) continuing to use IPSAS 19 as a source of guidance; or (ii) modifying IPSAS 23 to deal with both revenue and expenses.</p>	<p>The non-exchange/exchange classification approach should be an option in the CP for both revenues and expenses.</p>
<p><b>8.4 Performance Obligation Approach</b></p> <p>This paper considered the types of transactions to which revenue recognition model in IFRS 15 could sensibly be applied. It grouped transactions in three categories.</p>	

IPSASB Agenda Item	Feedback from IPSASB in December
<p><i>Category A</i></p> <p>This category consisted of exchange transactions <i>plus</i> some transactions currently accounted for under IPSAS 23 (where there is an element of exchange, but there are three parties).</p> <p>Staff suggested that IFRS 15, together with some public sector modifications, could be used in accounting for category A transactions.</p> <p><i>Category B</i></p> <p>This category consisted of revenue transactions with performance obligations but which did not have some of the key characteristics of transactions within the scope of IFRS 15. For example, capital grants do not involve the transfer of goods or services to a customer.</p> <p>Staff expressed reservations about extending the application of IFRS 15 to any Category B transactions. Staff felt that significant modifications to IFRS 15 could be required.</p>	<p>The IPSASB agreed with the suggestions in the issues paper.</p> <p>The IPSASB asked staff to do more work on this category. The IPSASB wants to explore the application of IFRS 15 to a broader range of transactions with performance obligations.</p> <p><i>This paper responds to the IPSASB's request for more work in this area.</i></p>
<p><i>Category C</i></p> <p>This category consisted of non-exchange transactions that do not have performance obligations.</p>	<p>The IPSASB agreed that a performance obligation approach was not appropriate for these transactions. Guidance in the form of a revised IPSAS 23 would still be required for transactions without performance obligations.</p> <p><u><a href="#">Additional feedback on performance obligation approach</a></u></p> <p>In addition to providing feedback on Categories A-C, the IPSASB commented that the performance obligation approach should take a broad view of (i) binding arrangements in the public sector (specific legislative requirements can give rise to performance obligations); and (ii) the enforceability of binding arrangements, which is not just through legal means.</p>

IPSASB Agenda Item	Feedback from IPSASB in December
<b>8.5 Whether to develop Consultation Papers</b> Whether the revenue and non-exchange expense projects should have Consultation Papers (CP).	Yes. A single CP for both projects (open to reconsideration as the shape and size of the paper becomes evident). The CP should set out two alternative approaches: (i) exchange/non-exchange classification; and (ii) performance obligation/no performance obligation.

6. The IPSASB's meeting summary for December 2015 stated:

The IPSASB agreed that it would like to develop a performance obligation approach that could be applied to a much broader range of revenue and expense transactions that contained performance obligations. This included transactions that would broadly meet the criteria set out in IFRS 15 (Category A transactions as noted in the Issues Paper) and transactions that would not meet the criteria set out in IFRS 15 but that are subject to performance obligations (Category B transactions as noted in the Issues Paper). The Category B transactions to be explored further are those where there is no transfer of control of the resources.
7. The Revenue Task-Based Group has had an opportunity to provide feedback on an earlier version of the capital grants section of the paper. It has not had the opportunity to provide feedback on the other sections of the paper.
8. The Board's decisions about whether the performance obligation approach in IFRS 15 should be extended to some or all Category B transactions will have an impact on the nature and amount of work that would be required to develop an IPSAS to replace IPSAS 9 and IPSAS 11. This is an open question as the IPSASB is still considering its options, but staff views on how the IPSASB's decisions might affect the development of an IPSAS are set out below.
9. If the IPSASB were to limit the application of the performance obligation approach in IFRS 15 to Category A transactions, a significant amount of work would be required (to address the public sector issues previously identified in the June 2015 agenda papers), but the new IPSAS could be based very closely on IFRS 15.
10. If the IPSASB were to extend the application of the performance obligation approach in IFRS 15 to some or all of the Category B transactions, more substantial rewriting of IFRS 15 would be required. In this paper we have explored some of the ways in which IFRS 15 could be modified to deal with Category B transactions. That has involved looking at possible wording changes to some definitions. These suggestions were intended to give the IPSASB an overall feel for the issues involved and to form an opinion about whether an extension of IFRS 15 to these transactions could work. The IPSASB would still need to decide how extensive any modifications should be and whether certain sections should be "modified" or completely rewritten. The proposed timetable in the project brief was based on an assumption that IFRS 15 would be modified rather than substantially rewritten.

11. As agreed by the IPSASB in December 2015, a performance obligation approach would not be appropriate for Category C transactions. These would still need to be considered in a revised IPSAS 23. Therefore these are not considered in this paper.
12. Table 2 outlines the objective of this paper in relation to the Board's discussions to date. We have tried to summarize the Board's previous discussions and explain how the discussion at this meeting will shape the work going forward. The objective at this meeting is to consider whether any Category B transactions could be addressed in a standard based on the performance obligation approach in IFRS 15, and if so, whether this would be appropriate.

**Table 2 Roadmap of Discussions to Date and the Objectives of this Paper**

Category A	Category B	Category C
Mostly exchange Plus non-exchange transactions involving the provision of goods and services to third parties	Non-exchange Some will have IPSAS 23 <i>conditions</i> Some will have IPSAS 23 <i>restrictions</i>	Non-exchange
Clear performance obligations	Transactions with a spectrum of obligations ranging from very clear obligations to more general obligations. This papers looks at a capital grants, research grants and some other grants to see if the performance obligation approach in IFRS 15 could be extended to those types of transactions. Need to consider issues such as: <ul style="list-style-type: none"> <li>• Is the obligation clear enough (sufficiently specific)?</li> <li>• Is the obligation enforceable?</li> <li>• How to demonstrate satisfaction of a performance obligation?</li> </ul>	No performance obligation
The IPSASB's tentative conclusion is that application of the performance obligation approach in IFRS 15 <i>is</i> appropriate for Category A transactions	The IPSASB has not formed a view on this yet. The IPSASB wants to explore the implications of extending the performance obligation approach to more revenue transactions. So, Category B transactions could end up being split between two revenue standards. The question would be how to create a clear scope for each standard	The IPSASB's tentative view is that application of the performance obligation approach in IFRS 15 <i>is not</i> appropriate for Category C transactions

Category A	Category B	Category C
<b>Implications for developing revenue standards</b>		
Modifying IFRS 15 to apply to Category A transactions would be similar to a convergence project. Some modifications would be required (refer June 2015 agenda papers), but we are confident it could be done.	<p>Modifying IFRS 15 to apply to some Category B transactions such as capital grants would require a lot of changes.</p> <p>This paper looks at the types of modifications that would be required and invites the IPSASB to consider whether such changes would be appropriate.</p> <p>This paper notes some risks in extending the performance obligation approach in IFRS 15 to a broader range of transactions.</p> <p>To the extent that some Category B transactions would still fall within the scope of a revised IPSAS 23, we would still need to look at ways of addressing IPSAS 23 issues.</p>	<p>Category C transactions would still fall within the scope of a revised IPSAS 23.</p> <p>We would need to look at ways of addressing IPSAS 23 issues.</p>
<p>The Consultation Paper will need to indicate the IPSASB's views on which transactions the performance obligation approach in IFRS 15 should be applied to. These could be discussed using the following headings:</p> <ul style="list-style-type: none"> <li>(a) Exchange transactions (IPSAS 9 and IPSAS 11);</li> <li>(b) Non-exchange transactions involving the provision of goods and services to third parties; and</li> <li>(c) Other non-exchange transactions with performance obligations <i>[we would need to identify the characteristics of such transactions or split them into subsets, such as capital grants, and ask questions about the subsets]</i></li> </ul> <p>The Consultation Paper should also explain why the IPSASB considers that any proposals to broaden the scope of the performance obligation approach in IFRS 15 are consistent with the Conceptual Framework.</p>		<p>The Consultation Paper will need to identify issues with IPSAS 23 and possible ways of addressing those issues.</p>

13. The Board is being asked for its views on the structure of the [draft] Consultation Paper in agenda item 11. The Board's views on the issues in this paper will influence its thinking about how the [draft] Consultation Paper should be set out.

## Transactions Considered in this Paper

14. In the December 2015 agenda papers we introduced the term “Category B” transactions as a quick way of referring to a broad range of transactions with some type of performance obligation. The distinguishing feature between Category A transactions and Category B transaction was that Category B transactions did not have one or more of the underlying characteristics required or assumed by IFRS 15. For the purpose of Board discussions on this issues paper, we have continued to use the term Category B. We think of Category B as sitting in the middle of a spectrum with some having more of the characteristics required or assumed by IFRS 15 than others.
15. The key characteristics of transactions that IFRS 15 requires or assumes are:<sup>3</sup>
  - (a) The agreement is about a promise to deliver goods and services to a customer;
  - (b) The rights and obligations in the agreement are set out in contracts;
  - (c) The rights and obligations in the agreement are enforceable;
  - (d) Both parties to the agreement intend to do what they have promised;
  - (e) The entity that has promised to deliver goods and services will do so, or the customer will take action against them (using the terms and conditions in the agreement or rights under contract law);
  - (f) The customer will pay for the goods and services or the entity that has delivered the goods and services will take action against them (using the terms and conditions in the agreement or rights under contract law);
  - (g) There is sufficient detail in the agreement to identify the point(s) at which the performance obligation is satisfied; and
  - (h) Any prepayments will be applied to the production of the promised goods and services or will be refunded.
16. In order to explore the application of the performance obligation approach in IFRS 15 we have identified a few types of transactions which people will be familiar with, and whose terms and conditions are often set out in contracts or binding agreements. In reality, for each of the types we have considered, there are likely to be a range of performance obligations, ranging from the very specific to the less specific.
17. The types of Category B transactions discussed in this issues paper are:
  - (a) Capital grants;
  - (b) Research grants or agreements; and
  - (c) Specific grants for identifiable programs (with sufficiently specific performance obligations).
18. None of these transactions involve the transfer of promised goods or services to customers (which is a key characteristic of performance obligations within the scope of IFRS 15). Instead they require that an entity delivers on another type of promise to do something. Before looking at these transactions in detail we have considered how they would be described using IPSAS 23 terminology.

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<sup>3</sup> This list is drawn from IFRS 15 paragraph 9 and the fact that, in writing IFRS 15, the IASB was thinking about exchange transactions.



19. IPSASs do not define the term grants. IPSAS 23 defines the term transfers and then explains that grants are a type of transfer. Extracts from IPSAS 23 follow.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes. (IPSAS 23, paragraph 7)

Transfers include grants, debt forgiveness, fines, bequests, gifts, donations, and goods and services in-kind. (IPSAS 23, paragraph 77)

20. IPSAS 23 discusses the terms that may be imposed on the use of transfers. It uses stipulations as the general term and distinguishes between restrictions and conditions.

Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity. (IPSAS 23, paragraph 7)

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified. (IPSAS 23, paragraph 7)

Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor. (IPSAS 23, paragraph 7)

21. Using IPSAS 23 terminology, the grant transactions discussed in this issues paper are *transfers* with *restrictions* or *conditions*.
22. This paper considers whether restrictions and conditions attaching to various types of grants give rise to performance obligations to which the revenue recognition model in IFRS 15 could be applied. Both conditions and restrictions may be outlined in a contract or other agreement. Because conditions involve the return of funds, they are more likely to be mentioned in contracts or other agreements. Contracts, by their nature, are generally enforceable through contract law. We envisage that the scope of any IPSAS based on IFRS 15 would be limited to contracts or binding arrangements that are enforceable. Additional guidance might be required about what enforceability means in a public sector context. As discussed later in this paper we think that some mechanisms such as ministerial directives to do something could be regarded as enforceability mechanisms for a standard. However, other self-enforcement mechanisms such as arbitration and mediation would not.
23. The degree of detail in the contract or binding arrangement is also relevant. In order to apply the revenue recognition model in IFRS 15 there must be sufficient detail to identify the point(s) at which the recipient entity is entitled to keep funding (based on when the obligations associated with the promise have been satisfied).

## Capital Grants

24. IPSASs do not define capital grants, although there are some IPSASs (for example, IPSAS 5, *Borrowing Costs*) which refer to capital grants. Using IPSAS 23 terminology, a capital grant is a transfer which stipulates that the grant is to be used for the acquisition or construction of a non-current asset. In its simplest form, the grant is given to the recipient, the asset is acquired or constructed, and the asset then belongs to the recipient.
25. Capital grants may be accompanied by restrictions or conditions, but given the sums involved, they are more likely to be accompanied by conditions. A common condition is that the recipient must use the grant to acquire or construct the capital asset, or return the grant. In addition, there may be other conditions or restrictions on the grant, such as:
  - (a) The recipient may be required to raise a certain amount of funding from other sources;
  - (b) The recipient may be required to continue using the asset for a specified purpose for a period of time;
  - (c) The recipient may be required to spend the funds on the capital asset within a certain time period; and
  - (d) The recipient may be required to make the asset available for use by the community.
26. Under IPSAS 23 the distinction between conditions and restrictions is important because a condition gives rise to a liability and a restriction does not. The distinction between conditions and restrictions is not important from an IFRS 15 perspective. For application of IFRS 15 it is more important that the agreement clearly sets out rights and obligations and is enforceable. However, IFRS 15 needs to be viewed as a whole. It is built around performance obligations in enforceable contracts and the expectation that the rights and obligations in the contract will be enforced. It is also based on the commercial assumption that if agreed goods and services are not delivered that any consideration paid will be returned.
27. Given the assumptions or expectations around which IFRS 15 is built (for example, enforceability), the recognition of liabilities under IFRS 15 is consistent with the definition of a liability in the IASB and IPSASB's conceptual frameworks. If we were to remove some of these assumptions or expectations underpinning IFRS 15, some advance payments might not meet the definition of a liability. As we consider whether the performance obligation approach in IFRS 15 could be used for a broader set of transactions in the public sector, we need to keep thinking about whether it would be appropriate to allow for the recognition of a liability if there is doubt about whether the entity will be forced to deliver on its promise or return any consideration received. We also need to think about whether the additional guidance that would be required to deal with changes in the assumptions or expectations underpinning IFRS 15 would sit best in a performance obligation standard or a residual revenue standard.
28. This section of the paper considers what changes would need to be made to IFRS 15 to allow the revenue recognition model in that standard to be applied to a capital grant. We have done in this in two ways. First, we have gone through the five steps in applying IFRS 15 to briefly indicate where issues would arise (the steps in IFRS 15 are summarized in an appendix to this paper). Then we have provided more detail about issues and possible solutions in Table 3.

29. The five steps in applying IFRS 15 and the issues that would arise if IFRS 15 were applied to capital grants are:

- (a) Step 1 – Identify the contract(s) with the customer. Some of the criteria for identifying are contract are missing. There is no transfer of goods or services to a customer. The entity that acquires or constructs the asset keeps control of the asset. The contract might not be enforceable or there might be no expectation that it would be enforced.
- (b) Step 2 – Identify the performance obligations in the contract. For the purposes of revenue recognition IFRS 15 requires that distinct performance obligations be identified. It might be possible to identify distinct obligations in a capital grant agreement, but the IFRS 15 guidance about identifying distinct performance obligations is based around the benefits to the customer. In the case of capital grants the benefits to the customer are likely to be difficult to identify, or even if they are identifiable, they are unlikely to form an appropriate basis for identification of distinct performance obligations.
- (c) Step 3 – Determine the transaction price. The transaction price refers to the transfer of goods and services. In the case of a capital grant there is no transfer of a good or service.
- (d) Step 4 – Allocate the transaction price. This step also is based around the transfer of goods and services. Allocation of the transaction price is based on the relative stand-alone selling prices of each distinct component of the good or service. Relative standard alone prices may not be available. However, this issue is not confined to capital grants. It is a broader issue that would need to be addressed in any IPSAS based on IFRS 15.
- (e) Step 5 – Recognize revenue when a performance obligation is satisfied. IFRS 15 requires that an entity recognize revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. In the case of a capital grant there is no transfer of a good or service. <sup>4</sup>

**Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup>**

Scope	<p>If capital grants were to be brought within the scope of a standard based on IFRS 15, extensive changes would be required to the scope section.</p> <p>There would need to be additional scope requirements to determine whether a transaction falls within the scope of this standard (IFRS 15 modified) or a residual revenue standard (IPSAS 23 revised).</p> <p>One possibility would be to introduce a requirement that to qualify as a performance obligation, an entity's promise to transfer a good or service to a counterparty in a contract must be <i>sufficiently specific</i> to be able to determine when the obligation is satisfied.</p> <p>This is the approach used by the Australian Accounting Standards Board (AASB) in a recent Exposure Draft to distinguish between revenue that</p>
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<sup>4</sup> We have summarized these steps in relation to capital grants but not in the subsequent sections on research grants or other grants. There would be similar difficulties in applying the five steps to those other transactions.

<sup>5</sup> This Table (and the subsequent tables) is intended to give an indication of the key issues rather than all the issues. For example, it does not discuss each defined term in IFRS 15.

**Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup>**

	<p>should be accounted for in accordance with IFRS 15 and revenue that should be accounted for in accordance with a residual revenue standard.<sup>6</sup> The AASB has also proposed that such performance obligations must be enforceable (or part of an agreement that is enforceable).</p> <p>IFRS 15 refers frequently to the transfer of goods and services. The scope section is one of the first places where this occurs. For example, paragraph 5 limits the scope of the scope of the standard to contracts with customers and the definitions of these terms refer to the transfer of goods and services. Paragraph 6 goes on to distinguish between contracts with customers (whereby goods and services are transferred to the customer) and collaborative activities whereby the risks and benefits are shared.</p>
Recognition	<p>Paragraph 9 of IFRS 15 is a key paragraph because it sets out a number of expectations about what constitutes an enforceable contract. It refers in a number of places to the transfer of goods and services.</p> <p><b>9 An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:</b></p> <ul style="list-style-type: none"> <li><b>(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;</b></li> <li><b>(b) the entity can identify each party's rights regarding <i>the goods or services to be transferred</i>; [emphasis added]</b></li> <li><b>(c) the entity can identify the payment terms for <i>the goods or services to be transferred</i>; [emphasis added]</b></li> <li><b>(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and</b></li> <li><b>(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for <i>the goods or services that will be transferred to the customer</i>. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52). [emphasis added]</b></li> </ul> <p>In the case of a capital grant, there is no transfer of a good or service to a customer. The satisfaction of the performance obligation occurs through the acquisition or construction of an asset.</p> <p>This issue could be addressed by replacing all references to the "transfer of goods and services" with references to the "satisfaction of a performance obligation". This option would involve extensive rewording. However, the intention would be clear throughout the standard.</p> <p>The issue could also be addressed by adding a general statement that all references to the transfer of goods and services should be read as including</p>

<sup>6</sup> AASB ED 260 *Income of Not-for-Profit Entities* (April 2015).

<b>Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup></b>	
	the satisfaction of a performance obligation within the scope of the standard. This approach would require less work, but it would be important to make sure that the Board's intention was clear to readers.
Definition contract	<p>IFRS 15 defines a contract as:</p> <p style="padding-left: 40px;">An agreement between two or more parties that creates enforceable rights and obligations.</p> <p>Enforceability is a key requirement in IFRS 15. The main issue for a public sector standard would be what additional guidance was required about enforceability. This is discussed towards the end of this paper.</p>
Definition customer	<p>IFRS 15 defines a customer as:</p> <p style="padding-left: 40px;">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.</p> <p>In considering the application of IFRS 15 to capital grants the definition of a customer would give rise to a number of issues.</p> <p><i>Keep the Term Customer?</i></p> <p>The first issue is to do with the term customer, rather than the definition. For example, should we refer to customers, replace customers with a more generic term such as resource providers (which would be consistent with the Conceptual Framework) or provide an explanation that, in the case of capital grants, the term customer can encompass resource providers?</p> <p>Our preference at this stage would be to continue using the term customer and provide an explanation that, in the case of capital grants, the term customer can encompass resource providers. Our preference would also be to make as few changes as possible to the definition of a customer.</p> <p>Reasons for proposing to continue using the term customer and to make only essential changes are:</p> <ul style="list-style-type: none"> <li>• There are a number of exchange transactions in the public sector where the definition of a customer works in exactly the same way as in the private sector. Readers would expect the term customer to be used in these situations.</li> <li>• There are some non-exchange transactions where the definition could still be appropriate (for example, if a resource provider pays for goods and services to be delivered to someone else rather than receiving the goods or services directly). When similar situations occur in the private sector (for example, people order gifts to be delivered to others) the term customer is still used to refer to the party paying. Some additional explanation could be inserted to clarify this.</li> </ul> <p><i>Obtain Goods or Services</i></p> <p>The definition of a customer refers to the customer obtaining goods or services. However, in the case of a capital grant, the grantor does not obtain goods or services (either directly or indirectly through them being</p>

**Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup>**

	<p>provided to third parties). The entity receiving the capital grant acquires or constructs the asset and keeps control of the asset.</p> <p>We have thought about ways of addressing this issue for capital grants. Options that we have considered, but which we would not recommend, are:</p> <p>(a) Arguing that the customer obtains control of the completed asset and immediately donates the asset back to the recipient. We do not support this approach because we do not think it represents the substance of the transaction.</p> <p>(b) Modify the definition of a customer to say that the customer obtains goods or services <i>or obtains other benefits from the satisfaction of performance obligations that it has imposed on the recipient</i>. We do not support this approach because we think it would be difficult to be specific about the nature or amount of the benefits. For example, the benefit could be a sense of wellbeing from supporting an organisation that one believes in. Or, the benefit could come from the asset being used to provide goods and services that the capital grant provider would otherwise have provided.</p> <p>One approach that might work where there is no direct benefit to the resource provider (the customer) is to refer to the customer <i>receiving satisfaction of the performance obligation</i>.</p> <p><i>Ordinary Activities</i></p> <p>The definition refers to the customer receiving goods or services that are <i>an output of the entity's ordinary activities</i>. Although this might be true for an entity that constructs or sells assets (such as a Public Works Department), in most cases the asset to which the capital grant is to be applied will not be an output of the entity's ordinary activities. Both for this reason, and because the IPSASB has adopted a broad definition of revenue which does not distinguish between ordinary activities and gains,<sup>7</sup> the definition of a customer (and the definition of revenue) would need to be changed to omit references to ordinary activities.</p> <p>Although removing references to ordinary activities would be necessary to align with the IPSASB's definitions of elements, this would not require many changes to IFRS 15.</p>
Definition performance obligation	<p>IFRS 15 defines a performance obligation as:</p> <p>A promise in a contract with a customer to transfer to the customer either:</p> <p>(a) a good or service (or a bundle of goods or services) that is distinct; or</p> <p>(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.</p>

<sup>7</sup> The definition of revenue in the Conceptual Framework is "Increases in the net financial position of the entity, other than increases arising from ownership interests."

**Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup>**

	<p>IFRS 15 (paragraphs 22 to 30) discusses the identification of performance obligations within a contract. Paragraph 24 distinguishes between tasks that might be performed, and the transfer of goods and services to customers.</p> <p>Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.</p> <p>The definition of a performance obligation refers to contracts and customers. In previous agenda papers we have suggested that the term contract would need to be replaced by a term such as binding arrangements. We have discussed possible modifications to the term customer above.</p> <p>The definition also refers to the transfer of goods and services, but, in the case of capital grants there is no transfer of a good or service to a customer. A possible solution would be to modify the definition to refer to the transfer of goods or services <i>or the satisfaction of performance obligations</i>.</p> <p>The definition of a performance obligation refers to <i>distinct</i> goods and services. Entities applying IFRS 15 will need to make judgments about when goods and services are distinct. We think it would be possible for public sector entities to make judgments about when a capital grant is “distinct”.</p> <p>In some jurisdictions there have been discussions as to whether an obligation to use an asset in a certain way in the future gives rise to a liability and allows for the recognition of capital grant revenue over the life of the asset.<sup>8</sup></p> <p>If we were drafting at what performance obligation should be the driver for revenue recognition in a standard based on IFRS 15, we would prefer to focus solely on the initial obligation to construct or acquire the asset. We think that additional obligations to use the asset in a certain way in the future should be considered and accounted for separately. This is because we can see how the performance obligation approach in IFRS 15 could be applied to the obligation to construct or acquire an asset but we are less sure that ongoing obligations could be regarded as performance obligations (giving rise to liabilities) under IFRS 15</p>
Definition revenue	<p>IFRS 15 defines revenue as:</p> <p>Income arising in the course of an entity's ordinary activities.</p>

<sup>8</sup> For example, see a 2014 report of the Auditor General of British Columbia at <http://www.bcauditor.com/sites/default/files/publications/2014/special/report/AGBC%20ROPA-FINAL.pdf>

**Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup>**

	<p>As noted in the comments on the definition of customer (see immediately above) the definition of revenue would need to be aligned with the definition in the IPSASB's Conceptual Framework.</p> <p>When the entity providing the resources as part of the revenue transaction also has an ownership interest in the entity, the entity receiving resources needs to be able to identify whether those resources are part of a revenue transaction or represent a contribution from an owner. We do not plan to focus on this issue as it is a generic issue. Entities need to consider this issue when applying a number of IPSASs.</p>
Satisfaction of performance obligation	<p>Paragraph 31 of IFRS 15 sets out the overarching principle for revenue recognition. It states:</p> <p>31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.</p> <p>This principle refers to a limited set of performance obligations – being those that can be satisfied by the transfer of goods or services to a customer. As discussed above, an entity satisfies the performance obligation associated with a capital grant by acquiring or constructing the asset in accordance with the grant agreement, not by transferring goods or services to the customer/grantor.</p> <p>This raises the question of how an entity demonstrates that it has satisfied a performance obligation in relation to a capital grant. Most capital grants will require some form of reporting by the recipient to the grantor. The level of detail and frequency of this reporting will vary depending upon the grantor's procedures and the amount of money involved. The reporting to the grantor could range from a simple assertion that the money has been spent as intended, to providing details of receipts or reports from an independent expert. From the perspective of drafting an accounting standard we would not want to explain all the ways in which an entity could demonstrate satisfaction of a performance obligation. The key point for drafting a standard would be that the entity has a way of demonstrating satisfaction of a performance obligation.</p> <p>We would therefore suggest that the key revenue recognition principle be rewritten to focus on the satisfaction of a performance obligation to a customer/resource provider, with the satisfaction of capital grants performance obligations as an example of how satisfaction might occur.</p>
Thoughts on timing of cash flows and requirements to	<p>If transactions meet the criteria for the application of the revenue recognition model in IFRS 15, the timing of cash flows between the resource provider and the recipient does not affect the pattern of revenue recognition. Revenue is recognized as or when the performance obligation</p>



<b>Table 3 Modifications Required for IFRS 15 to be applied to Capital Grants<sup>5</sup></b>	
spend money in certain periods	<p>is satisfied. If consideration for goods and services is received in advance, then this gives rise to a liability.</p> <p>Under IFRS 15 the timing of revenue recognition might be similar to the timing of spending but this is not guaranteed.</p> <p>The other question that needs to be considered is whether a stipulation that money be spent in a certain period gives rise to a performance obligation. We do not think that time stipulations, on their own, give rise to performance obligations. Although a capital grant agreement may require that the money for the project be spent within a certain time frame, this would be a term of the agreement rather than a driver of revenue recognition. Under IFRS 15 prepayments give rise to contract liabilities. The entity derecognizes the contract liability (and recognizes revenue) when it transfers goods or services and, therefore, satisfies its performance obligation (IFRS 15 paragraph B44). If the entity doesn't satisfy that performance obligation it would either return the money and derecognize the contract liability, or account for whatever penalties it faces.</p>
Risks	<p>The risk with extending IFRS 15 to a broader range of transactions is that it becomes more difficult to distinguish between transactions that should be accounted for in accordance with a performance obligations approach and general funding. This might be less of a risk for capital grants (which are more likely to be well specified and enforced) than the other transactions considered in this paper. As one moves along the spectrum towards general funding it becomes more difficult to argue that there is a liability for consideration received in advance.</p>

30. Despite having outlined in Table 3 some of the ways in which IFRS 15 could be modified to account for revenue from capital grants in the public sector, we continue to have reservations about this possibility. Where a capital grant is for a specific asset, there is clearly defined start and end date, and there is an expectation that any funds required to be returned at the end of the agreement will be returned or that the requirements in the agreement will be enforced in some other way, the application of IFRS 15 may provide information that is useful for accountability and decision making.
31. However, in a scenario where capital grants are to be used for multiple assets, those assets are not clearly specified at the beginning of the agreement, and there is a history of an entity not returning unused funds, the foundations of IFRS 15 are not present and it would seem more appropriate for such transactions to be dealt with in a residual revenue standard, such as IPSAS 23. A residual revenue standard would need to consider the circumstances in which there is "a present obligation of the entity for an outflow of resources" as per the definition of a liability in the Conceptual Framework.
32. If the IPSASB extended the performance obligation approach to capital grants it would need to consider how this fits with the requirements of IPSAS 32 *Service Concession Arrangements: Grantor*. There is no IPSAS specifically dealing with service concession arrangements from an operator's perspective. One would expect that an operator receiving funding to construct an asset in accordance

with a service concession arrangement would account for the revenue in accordance with IPSAS 11 *Construction Contracts*.

## Research Grants

33. Using IPSAS 23 terminology, a research grant is a transfer with stipulations. The stipulations may be restrictions or conditions. Although the terms and conditions of research grants vary<sup>9</sup>, at their heart they involve payments for research. The rights and obligations of the parties are normally set out in a research agreement. Some research agreements may meet the definition of an exchange transaction, but, more often they would be classified as non-exchange transactions because the resource provider gets limited benefits in relation to the resources provided.
34. Despite the fact that many research agreements would be classified as non-exchange transactions and fall within the scope of IPSAS 23, they do involve obligations to carry out certain tasks, document findings and disseminate knowledge. If there are conditions associated with the agreement, IPSAS 23 would allow for revenue recognition over time as the conditions are satisfied. However, if there are no conditions, only restrictions, IPSAS 23 would require immediate recognition of revenue at the time payment is received. When there are large up-front payments as part of the research agreement, revenue is recognized at the beginning of the project rather than as the work is carried out. For projects that take place over more than one year this can result in large fluctuations in reported revenue and surplus/deficit. Entities often feel that the revenue reported in accordance with IPSAS 23 does not reflect their actual performance.
35. In this issues paper we consider how the requirements of IFRS 15 could be useful in accounting for research agreements, and the challenges that the IPSASB would face in extending the revenue recognition model in IFRS 15 to performance obligations in research agreements.
36. Application of the revenue recognition model in IFRS 15 could result in revenue recognition that is regarded as being more representative of the substance of certain research agreements. This is because, IFRS 15 requires the recognition of revenue when the performance obligation is satisfied (as opposed to when money comes in) and in some circumstances IFRS 15 allows for the recognition of revenue over time. Step 5 of the revenue recognition model in IFRS 15 is to recognize revenue as a performance obligation is satisfied. The performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For a performance obligation satisfied over time, an entity would select an appropriate measure of progress to determine how much revenue should be recognized as the performance obligation is satisfied. Although research agreements can involve the development and transfer of goods such as intangible assets, they are more likely to involve services.
37. If public sector entities were to apply IFRS 15 to account for revenue from research agreements, some of the challenges that they would encounter would be similar to those faced by private sector research entities applying IFRS 15. For example, they would need to:
  - (a) Identify all separate performance obligations. This would involve considering whether the separate phases of the research project constitute separate performance obligations. Where

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<sup>9</sup> Examples of terms and conditions that differ between agreements include whether the amount of revenue is fixed or based on costs incurred, whether the recipient has to return any unspent funds, and who has the rights to use any knowledge obtained during the project in writing papers or developing commercial proposals.

the phases of the research agreement are interrelated there is more likely to be a single performance obligation; and

- (b) Decide whether any licenses granted represent the transfer of a right to use an entity's intellectual property (recognized at a point in time) or licenses that represent the provision of access (recognized over a period of time).
38. In addition to these typical implementation challenges, public sector entities would face other difficulties in trying to apply IFRS 15 to account for revenue from research agreements. As noted in December 2015 agenda papers (paper 8.4) possible difficulties include:
- (a) Whether research agreements are sufficiently enforceable for the revenue recognition model in IFRS 15 to be appropriate. IFRS 15 was developed for situations where the customer can enforce the agreement (either by demanding the return of money or requiring the research entity to do more work to satisfy the performance obligations).
  - (b) There may be no transfer of a good or service back to the customer or the only good or service transferred (for example, the research report) may be small in relation to the amount of work required to satisfy the performance obligations in the agreement. Because IFRS 15 is based around the transfer of control of a good or service to the customer, this could lead to an inappropriate emphasis on tangible outputs such as the research report.
39. This section of the paper considers what changes would need to be made to IFRS 15 to allow the revenue recognition model in IFRS 15 to be applied to research grants. Table 4 below gives an overview of the main modifications that would be required.
40. Because some of these modifications are similar to those that have already been discussed in Table 3, Table 4 refers in some places to Table 3.

<b>Table 4 Modifications Required for IFRS 15 to be applied to Research Grants</b>	
Scope and Recognition	<p>A small subset of research grants might fall within the scope of IFRS 15 as issued by the IASB. However, the revenue from many research grants would not fall within the scope of IFRS 15 either because, there is no transfer of a good or service to a customer, or, the item that is transferred (for example, the research report) may be minor in relation to the research agreement as a whole.</p> <p>The possible modifications discussed in Table 3 could also be used to extend IFRS 15 to a broader range of research grants. These modifications rely on the entity being able to demonstrate that it has satisfied a performance obligation.</p> <p>In the case of research grants, satisfaction of a performance obligation 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).</p>
Definition contract	As noted in Table 3, the main issue for a public sector standard would be what additional guidance was required about enforceability.

<b>Table 4 Modifications Required for IFRS 15 to be applied to Research Grants</b>	
Definition customer	<p>The issues (and possible solutions) identified in Table 3 in relation to capital grants would also apply to research grants.</p> <p>These issues included:</p> <ul style="list-style-type: none"> <li>• Whether to keep the term customer or replace it with a more generic term such as resource providers.</li> <li>• Whether to modify the definition of a customer to refer to both the receipt of goods and services <i>and the satisfaction of performance obligations</i>. Although the customer may receive a research report, the completion of a research report is likely to be only one of many obligations in the research agreement. The customer may also obtain some intangible rights but this will not be the case in all research agreements.</li> <li>• The need to remove references to ordinary activities.</li> </ul>
Definition performance obligation	<p>The issues (and possible solutions) identified in Table 3 in relation to capital grants would also apply to research grants. These issues included:</p> <ul style="list-style-type: none"> <li>• The need to replace references to contracts with a term such as binding arrangements.</li> <li>• The need to consider changes to the term customer (as discussed above).</li> <li>• The need to expand the triggers for revenue recognition. IFRS 15 focuses on the transfer of goods and services. This focus would need to be expanded to refer to the satisfaction of performance obligations.</li> </ul> <p>However, there is a further issue to be considered in relation to research grants. Because IFRS 15 is based on the satisfaction of a performance obligation, that performance obligation needs to be sufficiently clear that both parties are in agreement about what the performance obligation is, and how it would be satisfied.</p> <p>This is less of an issue for capital grants because the obligation to acquire or construct a particular asset is fairly specific. Where a grant is for a single research project which has a defined beginning and end and a clear description of the work that will be carried out during the project, the obligation is also fairly clear. The problem is that stipulations in research grants can range from being very specific to general. The IFRS 15 approach does not work for agreements where the work to be done is not sufficiently clear. If the IPSASB decides to proceed with a performance obligation/no performance obligation approach when developing revenue IPSASs, it would need to provide guidance on the scopes of the respective standards. As noted above, one option would be to limit the scope of a performance obligation standard to transactions with sufficiently specific and enforceable obligations.</p>

<b>Table 4 Modifications Required for IFRS 15 to be applied to Research Grants</b>	
Definition revenue	As discussed in Table 3, the definition of revenue would need to be aligned with the Conceptual Framework.
Satisfaction of performance obligation	<p>As discussed in Table 3, the revenue recognition principle in IFRS 15, paragraph 31 is based on the satisfaction of a performance obligation to transfer goods or services to a customer.</p> <p>However, the transfer of goods or services to a customer is only one way that an entity may satisfy the performance obligations associated with a research grant. An entity may satisfy the performance obligations in a research grant agreement in a variety of ways including:</p> <ul style="list-style-type: none"> <li>• Carrying out the research;</li> <li>• Making the research results available to students or the public;</li> <li>• Using the knowledge obtained to develop goods or services that will benefit both the entity, and the community or country in which the entity operates.</li> </ul> <p>As per the discussion in Table 3, we think that the key revenue recognition principle in IFRS 15 would need to be rewritten to focus on the satisfaction of a performance obligation to a customer, with the transfer of a promised good or service as an example of how satisfaction might occur.</p> <p>The satisfaction of a performance obligation could be based on progress reports from the entity to the customer. These could include formal assertions regarding the satisfaction of performance obligations.</p>
Thoughts on timing of cash flows and requirements to spend money in certain periods	Refer to the comments in Table 3.
Risks	<p>Refer to the comments about risks in Table 3.</p> <p>Research grants range from the very specific and enforceable to the more general. At one end of the spectrum the risks might be small, but at the other end of the spectrum we have concerns that applying the performance obligations approach in IFRS 15 could permit the recognition of liabilities when this would not be consistent with the Conceptual Framework.</p>

### Specific Grants for Identifiable Programs

41. Grants for identifiable programs could fall along a spectrum. Using the classifications from the December 2015 agenda papers (item 8.4) such grants could be for:

- (a) Specific goods and services to be provided to the resource provider (classified as Category A – an exchange transaction);

- (b) Specific goods and services to be provided to third parties (classified as Category A – like an exchange transaction even though it involves three parties); and
- (c) Specific activities, but with the recipient entity having the right to decide what goods and services it will provide and to whom or where the entity carries out activities and there is no clearly identifiable recipient (classified as Category B – there is an obligation to do some work or spend money in a certain way, but the transaction is missing some of the key characteristics envisaged by IFRS 15).
42. Using IPSAS 23 terminology these grants would have conditions or restrictions.
43. This section of the paper considers what changes would need to be made to IFRS 15 to allow the revenue recognition model in IFRS 15 to be applied to “Category B” grants. The paper does not consider those where there is no performance obligation (referred to as Category C).
44. Table 5 below gives an overview of the main modifications that would be required. Because some of these modifications are similar to those already discussed earlier in this paper, Table 5 also refers to Table 3.
45. We have assumed from the outset that the grants have sufficiently specific performance obligations.

<b>Table 5 Modifications Required for IFRS 15 to be applied to Grants for Specific Programs</b>	
Scope and Recognition	<p>The reasons why revenue from these type of grants is unlikely to fall within the scope of IFRS 15 include:</p> <ul style="list-style-type: none"> <li>• There is no transfer of a good or service to a customer; and</li> <li>• There is a transfer of goods and services, but the entity receiving the grant has some discretion about what it does and who it transfers goods and services to.</li> </ul> <p>The possible modifications discussed in Table 3 could also be used to extend IFRS 15 to some of these grants. These modifications rely on the entity being able to demonstrate that it has satisfied a performance obligation.</p> <p>Satisfaction of a performance obligation 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).</p>
Definition contract	As noted in Table 3, the main issue for a public sector standard would be what additional guidance was required about enforceability.
Definition customer	<p>The issues (and possible solutions) identified in Table 3 in relation to capital grants would also apply to these grants.</p> <p>These issues included:</p> <ul style="list-style-type: none"> <li>• Whether to keep the term customer or replace it with a more generic term such as resource providers.</li> <li>• Whether to modify the definition of a customer to refer to both the receipt of goods and services <i>and the satisfaction of performance obligations</i>.</li> </ul>

<b>Table 5 Modifications Required for IFRS 15 to be applied to Grants for Specific Programs</b>	
	<ul style="list-style-type: none"> <li>The need to remove references to ordinary activities.</li> </ul>
Definition performance obligation	<p>The issues (and possible solutions) identified in Table 3 in relation to capital grants would also apply to research grants. These issues included:</p> <ul style="list-style-type: none"> <li>The need to replace references to contracts with a term such as binding arrangements.</li> <li>The need to consider changes to the term customer (as discussed above).</li> <li>The need to expand the triggers for revenue recognition. IFRS 15 focuses on the transfer of goods and services. This focus would need to be expanded to refer to the satisfaction of performance obligations.</li> </ul> <p>In the preamble to this section we have assumed that we are focusing solely on grants with sufficiently specific performance obligations. However, we do need to consider what this means and how it could be given effect in a standard. Compared to capital grants and research grants, we think that it might be harder for an entity to demonstrate that it has satisfied a performance obligation associated with a grant for a specific program.</p> <p>If the program is a new activity that begins and ends and defined stages, demonstrating satisfaction of the performance obligation would be similar to a capital grant or research grant. However, if the money is provided for an ongoing activity of the entity, it then becomes much harder to distinguish between the activities that the entity would have carried out anyway, and the activities that the entity is carrying out in order to satisfy the resource provider.</p> <p>Again, the only solution that we have identified for this issue is to provide guidance on the scopes of the respective revenue standards. As noted above, one option would be to limit the scope of a performance obligation standard to transactions with sufficiently specific and enforceable obligations.</p>
Definition revenue	As discussed in Table 3, the definition of revenue would need to be aligned with the Conceptual Framework.
Satisfaction of performance obligation	<p>As discussed in Table 3, the revenue recognition principle in IFRS 15, paragraph 31 is based on the transfer of goods or services to a customer. The transfer satisfies the performance obligation.</p> <p>By contrast an entity may satisfy the performance obligations associated with a grant for a specific program in a variety of ways, often by completing an agreed activity.</p> <p>As per the discussion in Table 3, in order for IFRS 15 to be modified for some Category B transactions we think that the key revenue recognition principle in IFRS 15 would need to be rewritten to focus on the satisfaction of a performance obligation.</p>

<b>Table 5 Modifications Required for IFRS 15 to be applied to Grants for Specific Programs</b>	
	The satisfaction of a performance obligation could be based on progress reports from the entity to the customer. These could include formal assertions regarding the satisfaction of performance obligations.
Thoughts on timing of cash flows and requirements to spend money in certain periods	Refer to Table 3.
Risks	Refer to the comments about risks in Table 3 and 4.  We have concerns that applying the performance obligations approach in IFRS 15 to such transactions could permit the recognition of liabilities when this would not be consistent with the Conceptual Framework.

## Enforceability and Dealing with Non-performance

46. As noted earlier in this paper, IFRS 15 is built around performance obligations in enforceable contracts and the expectation that the rights and obligations in the contract will be enforced. This paper suggests that, for the performance obligation approach in IFRS 15 to be extended to a broader range of transactions than envisaged by IFRS 15, the agreements surrounding the performance obligations would need to be enforceable.
47. In order to assist the IPSASB in thinking about the implications of extending the performance obligation approach in IFRS 15 this section:
  - (a) Summarizes the requirements about enforceability in IFRS 15; and
  - (b) Considers the ways in which public sector entities might enforce agreements; and
  - (c) Provides some examples of how enforceability and non-performance have been addressed in agreements.

### *IFRS 15 and enforceability*

48. Consistent with the title of the standard, the scope of IFRS 15 is contracts with customers<sup>10</sup>. IFRS 15 defines a contract as “An agreement between two or more parties that creates enforceable rights and obligations.”
49. Paragraph 9 of IFRS 15 identifies certain characteristics that contracts must have in order to be accounted for in accordance with the Standard. These characteristics include that parties intend to perform their obligations. The Basis for Conclusions on IFRS 15 notes that the Boards considered that these characteristics were necessary in order for the contract to establish enforceable rights and obligations (paragraph BC31).
50. Paragraph 10 of IFRS 15 discusses enforceability. It states:

<sup>10</sup> Paragraph 5 of IFRS 15 identifies some contracts with customers that are excluded from the scope of the Standard.



- 10 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.
51. The discussion of enforceability in the Basis for Conclusions on IFRS 15 explains that enforceability is considered in the relevant legal framework, and that the factors that determine enforceability may differ between jurisdictions (paragraph BC32).
52. Paragraph 24 of IFRS 15 explains that although most performance obligations in a contract with a customer are explicitly stated in that contract, there may be some performance obligations that are "implied by an entity's customary business practices, published policies or specific statements". The Basis for Conclusions on IFRS 15 (paragraph BC87) says that the Boards noted that the implied promises do not need to be enforceable.

*Ways of enforcing agreements*

53. There are a variety of ways in which public sector entities can enforce obligations in agreements with other public sector entities. These depend on the legal system in place in a jurisdiction and the types of agreements that public sector entities can enter into. They can include:
- (a) Using the remedies set out in the contract or binding agreement (for example, penalties for late delivery or non-performance, ministerial directives);
  - (b) Using the remedies available under contract law (for example, damages, specific performance and injunctions);
  - (c) Using any remedies available under consumer protection law that applies to public sector entities (for example, the ability to return faulty goods or demand a refund);
  - (d) Reputation. This can include negative impacts on an entity's reputation (for example, public disclosure of unauthorised spending or non-performance) or making an entity aware that, if it does not meet its obligations under an agreement, it risks not having any future funding relationship;
  - (e) Consequences for the key management personnel (where delivering on the obligations in an agreement is part of an individual's performance assessment or remuneration);
  - (f) Self-enforcement mechanisms (for example, posting bonds, ending a commercial relationship);
  - (g) External review (for example, third party audits); and
  - (h) Alternative dispute resolution systems (for example, arbitration, mediation and conciliation hearings) often by industry bodies, specialised agencies or third party evaluators.
54. We consider that, in referring to enforceable obligations, IFRS 15 had in mind legal remedies or other external mechanisms, not self-enforcing mechanisms.

55. Where it is difficult to verify that the entity providing goods or services has met quality standards public sector entities may prefer to focus on establishing quality incentives rather than enforcement mechanisms. We have not found any discussion of quality incentives in IFRS 15. Entities may also establish principles guiding the way in which they operate. For example, they may agree to act in a co-operative manner and give each other reasonable notice of adverse events or risks.
56. Governments or large public sector entities may also establish procurement guidelines or standard agreements to make sure that agreements are as clear as possible and where appropriate, increase the likelihood that they could be enforced. Again, although such guidelines or standard agreements may increase the likelihood of agreements being honoured, they are not enforcement mechanisms.
57. We have asked for some feedback about enforceability mechanisms in the Matters for Consideration.

## Next Steps

58. The IPSASB has agreed to issue a Consultation Paper to seek constituents' views on possible approaches to developing new and revised standards for revenue and non-exchange expenses. Agenda item 11 is seeking feedback from the IPSASB on the structure and content of that Consultation Paper. The feedback on this issues paper will also influence the structure and content of the Consultation Paper. Constituents will need to understand:
  - (a) What type of revenue transactions the IPSASB thinks could sensibly be dealt with using a performance obligation approach;
  - (b) The types of modifications to IFRS 15 that would be required in order for it to be suitable for application to these transactions; and
  - (c) Which transactions would still fall within the scope of a revised IPSAS 23 and possible improvements to that standard.
59. The next steps in this project are therefore to draft the sections of the Consultation Paper dealing with these matters. The discussion at this meeting will provide some direction on (a) and (b) above and we could work on the sections of the Consultation Paper dealing with the performance obligations approach for the June meeting.
60. However, we still need to do more work on IPSAS 23 before we can identify possible improvements and before we can draft the sections of the Consultation Paper dealing with IPSAS 23. If the Board wanted, we could try and bring both an issues paper and draft Consultation Paper material to the June meeting. The Consultation Paper material would obviously be tentative and subject to the IPSASB's discussions in June, but it would be one way to proceed more quickly.

## Feedback Sought

61. This paper has attempted to explore some of the issues that would need to be considered if the Board were to propose extending the performance obligation approach in IFRS 15 to a wider range of transactions than envisaged by IFRS 15.
62. At this stage we are seeking feedback from the IPSASB on how it wants to package the issues discussed in this paper for constituents and what strategies it wants to put forward for dealing with them. A key message for constituents will be whether the IPSASB proposes to extend the scope of a standard based on IFRS 15 and the extent to which that could address any of the revenue issues

raised by constituents. They will also be interested in what the IPSASB proposes to do about some of the other revenue issues that have been identified.

**Matter(s) for Consideration**

*Feedback on Category B issues*

1. Does the IPSASB think it is *feasible* to modify the revenue recognition model in IFRS 15 (for example, by making satisfaction of the performance obligation the basis for revenue recognition) so that the IFRS 15 approach could be applied to:
  - (a) Capital grants;
  - (b) Research grants; and/or
  - (c) Grants for specific programs?
2. If the answer to question 1 is yes, does the IPSASB consider that this would be *appropriate*, having regard to the amount of work that would be required, the potential benefits for preparers and users and the definitions of elements in the Conceptual Framework?
3. Which types of enforcement mechanisms does the IPSASB consider should be required in an IPSAS based on the performance obligation approach in IFRS 15? (Please note, this question is relevant regardless of views on questions 1 and 2).

*Feedback on drafting the Consultation Paper*

4. What does the IPSASB want to say in the Consultation Paper about the application of the performance obligation approach in IFRS 15 to a broader range of revenue transactions than envisaged by IFRS 15? Possible ways of organizing this discussion are:
  - (a) Exchange transactions (currently dealt with under IPSAS 9 and IPSAS 11);
  - (b) Non-exchange transactions involving the provision of goods and services to third parties; and
  - (c) Other non-exchange transactions with performance obligations.
5. Does the IPSASB want the following agenda papers to be brought to the June meeting:
  - (a) Draft Consultation Paper sections on the application of the performance obligations approach to various categories of revenue;
  - (b) An issues paper on possible improvements to IPSAS 23; and
  - (c) Draft Consultation Paper section on possible improvements to IPSAS 23?

63. These questions are posed from a revenue perspective. Once the Board has formed a tentative view on these matters from a revenue perspective, it would also need to consider the implications for a performance obligation approach to non-exchange expenses.

## Appendix 1: Steps in Applying IFRS 15

This Appendix contains an overview of the “Steps” in applying IFRS 15.

<b>Steps in applying IFRS 15</b>	
Step 1 – Identify the contract(s) with the customer	<p>A contract is an agreement between two or more parties that creates enforceable rights and obligations.</p> <p>Criteria for identifying a contract (and therefore applying IFRS 15):</p> <ul style="list-style-type: none"> <li>• The parties have approved the contract</li> <li>• The entity can identify each party’s rights to goods and services to be transferred</li> <li>• The entity can identify payment terms</li> <li>• Contract has 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)</li> <li>• Probable that will collect consideration</li> </ul> <p>In some cases, IFRS 15 requires an entity to combine contracts and account for them as one contract. IFRS 15 also specifies how an entity would account for contract modifications.</p> <p>IFRS 15, paragraphs 9-21</p>
Step 2 – Identify the performance obligations in the contract	<p>Performance obligations are promises in a contract to transfer to a customer goods or services that are distinct. In determining whether a good or service is distinct, an entity considers 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. An entity also considers whether the entity’s promise to transfer the good or service is separately identifiable from other promises in the contract.</p> <p>IFRS 15, paragraphs 22-30</p>
Step 3 – Determine the transaction price	<p>The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.</p> <p>Usually, the transaction price is a fixed amount of customer consideration. Sometimes, the transaction price includes estimates of consideration that is variable or consideration in a form other than cash. Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Adjustments to the transaction price are also made for the effects of financing (if significant to the contract) and for any consideration payable to the customer.</p> <p>IFRS 15, paragraphs 46-72</p>

<b>Steps in applying IFRS 15</b>	
Step 4 – Allocate the transaction price	<p>An entity would typically allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service. If a stand-alone selling price is not observable, the entity would estimate it.</p> <p>Sometimes, the transaction price may include a discount or a variable amount of consideration that relates entirely to a specific part of the contract. The requirements specify when an entity should allocate the discount or variable consideration to a specific part of the contract rather than to all performance obligations in the contract.</p> <p>IFRS 15, paragraphs 73-90</p>
Step 5 – Recognize revenue when a performance obligation is satisfied	<p>An entity would recognize 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).</p> <p>A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For a performance obligation satisfied over time, an entity would select an appropriate measure of progress to determine how much revenue should be recognized as the performance obligation is satisfied.</p> <p>IFRS 15, paragraphs 31-45</p>