

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: June 19–22, 2018

From: Joanna Spencer and Paul Mason

Agenda Item 9

For:
☐ Approval
☒ Discussion
☐ Information

REVENUE AND NON-EXCHANGE EXPENSES – PUBLIC SECTOR PERFORMANCE OBLIGATION APPROACH

Project summaries	<p>Revenue</p> <p>The aim of the project is to develop one or more IPSASs covering revenue transactions (exchange and non-exchange).</p> <p>The scope of this project is to develop new standards-level requirements and guidance on revenue to amend or supersede that currently in IPSAS 9, <i>Revenue from Exchange Transactions</i>; IPSAS 11, <i>Construction Contracts</i>; and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i>.</p> <p>Non-Exchange Expenses</p> <p>The aim of the project is to develop a standard(s) that provides recognition and measurement requirements applicable to providers of non-exchange transactions, except for social benefits.</p>	
Meeting objectives	Topic	Agenda Item
Project management	Instructions–June 2017 meeting and before (Revenue)	8.1.1
	Instructions up to March 2018 meeting (Non-Exchange Expenses)	11.1.2
	Decisions–June 2017 meeting and before (Revenue)	8.1.2
	Decisions up to March 2018 meeting (Non-Exchange Expenses)	11.1.1
	Revenue Road Map	8.1.3
	Non-Exchange Expenses Road Map	11.1.3
Discussion Items at this meeting	Revenue – Public Sector Performance Obligation Approach	9.2.1
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	Non-Exchange Expenses: Public Sector Performance Obligation Approach	9.2.3

Agenda Item

9.2.1

Revenue – Public Sector Performance Obligation Approach

Question

1. The Board is asked to consider staff proposals on how to expand the requirements of IFRS 15 for suitability in the public sector and to decide if this is the approach that should be included in an exposure draft (ED) to account for transactions that were labelled 'Category B' in the Consultation Paper (CP) *Accounting for Revenue and Non-Exchange Expenses*.

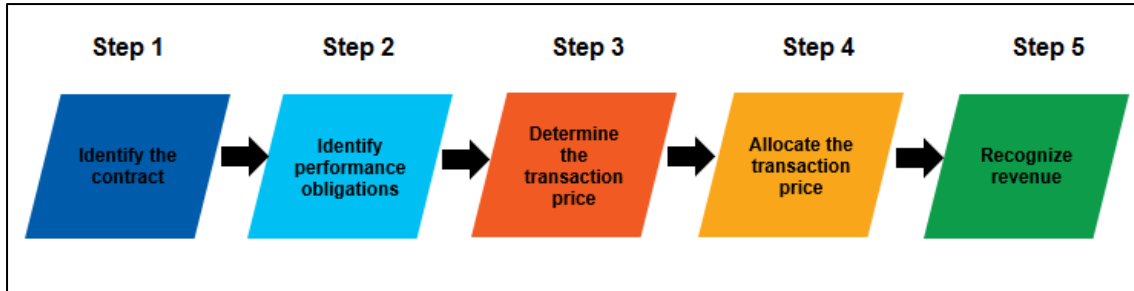
Background

2. The CP put forward two approaches for accounting for Category B transactions. Approach 1 was to retain the current exchange/non-exchange approach but update IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to address some of the application issues identified such as accounting for transactions with time requirements.
3. Approach 2 was to extend the five-step performance obligation approach in IFRS 15, *Revenue from Contracts with Customers* to suit public sector transactions. This approach, the Public Sector Performance Obligation Approach (PSPOA), was put forward as the Board's preferred approach in the CP as Preliminary View (PV) 3.
4. At the March 2018 IPSASB meeting staff provided the Board with feedback from the responses to the CP. The Board noted that 50% and 13% of respondents agreed or partially agreed with the PV with only 18% of respondents disagreeing (the other responses were either not clear (3%) or provided no comment to the PV (16%)). However, before deciding that the PSPOA should be included in an exposure draft for accounting for revenue the Board directed staff to develop the model further complete with examples¹ on which it could be tested.
5. This paper will detail how staff proposes to expand the requirements of IFRS 15 to form the PSPOA and will then test this approach against public sector specific examples.

¹ Illustrative Examples are provided as Agenda Item 9.2.2

Detail

6. IFRS 15 has a unique five-step approach to revenue recognition and within each step there may be sub-steps. Where necessary these steps (which are illustrated below) will need to be amended for applicability in the public sector.



Step 1 – Identify the Contract

7. The first step within the IFRS 15 model is to identify the contract.
8. IFRS 15 paragraph 9 is as follows:

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:
- (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) the entity can identify each party's rights regarding the goods or services to be transferred;
 - (c) the entity can identify the payment terms for the goods or services to be transferred;
 - (d) the 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); and
 - (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. 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.

9. Staff considers that the terms or phrases highlighted will require amending, clarification or guidance for use in the public sector.

Definition of Contract

10. At present 'Contract is not defined in IPSAS but is defined in IFRS 15 and IFRS 16, *Leases* as:

“An agreement between two or more parties that creates enforceable rights and obligations”

Staff is of the view that there are two issues with this definition, firstly the use of the word ‘contract’ and secondly regarding ‘enforceable rights’ of the agreement.

Contract

11. Staff considers that using the term ‘contract’ may be problematic because as noted in paragraph 5.20 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (The Framework)*, ‘There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect’. Therefore, as noted in the CP (paragraph 4.31) staff recommend that when the term ‘contract’ is used, an addendum of ‘or other binding arrangement’ be added². Staff note that the phrase ‘contract or other binding arrangement’ is already used with the IPSAS literature including *The Framework*.
12. Binding arrangement is defined in IPSAS 32, *Service Concession Arrangements: Grantor* as ‘contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. It is also defined in IPSAS 35, *Consolidated Financial Statements* as ‘an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights’.
13. Staff considers that either definition is suitable for the purposes of this project but favors the IPSAS 35 definition because it is more explanatory and recommends that this definition be included in any proposed IPSAS.

Enforceable rights

14. The second issue staff identified within the definition of a contract that may be problematic for public sector transactions is the enforceability of the contract, because IFRS 15 paragraph 10 states ‘Enforceability of the rights and obligations in a contract is a matter of law.’ The phrase ‘matter of law’ is not explained but may be interpreted to be enforceable by legal means only.
15. As mentioned at paragraph 2, at present IPSAS lacks a definition of ‘contract’ but Exposure Draft (ED) 64, *Leases* introduces the IFRS definition into IPSAS and provides further guidance as follows:

AG3 An entity considers the substance rather than the legal form of an arrangement in determining whether it is a “contract” for the purposes of this [draft] Standard. Contracts, for the purposes of this [draft] Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- (a) Contracts involving willing partners entering into an arrangement;
- (b) The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient

² Note this was suggested in Agenda Item 8.2.3.

to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and

(c) The remedy for non-performance is enforceable by law.

16. Therefore, the proposed guidance in ED 64 does not expand the concept of enforceability beyond legal enforceability. However, paragraph BC32 of IFRS 15 suggests that enforceability may be achieved by means other than legal means by stating: ‘Determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework **(or equivalent framework)** [*emphasis added*] that exists to ensure that the parties’ rights and obligations are upheld’.
17. Staff consider that because ‘binding arrangement’ should be used in conjunction with ‘contract’, enforceability should be extended beyond legal enforcement and as noted in the CP, mechanisms other than a return obligation (as in IPSAS 23) should also be incorporated to reflect the public sector context of the arrangements and include all situations where the transferor of resources is able to take remedies in the event of non-fulfillment of a performance obligation.
18. Staff considers that a contract or binding arrangement is enforceable when a separate party (either one of the parties to the arrangement or an alternative party) is able to enforce it by legal or other equivalent means. Therefore enforceability can be reflected by a range of non-contractual mechanisms including but not limited to:
 - (a) Legislation;
 - (b) Cabinet and ministerial decisions; and
 - (c) Reduction of future funding.³
19. Staff is of the view that moral obligations and loss of reputational risk should not be considered as non-contractual enforcement mechanisms.
20. Therefore staff recommend that guidance on non-legally binding enforceability mechanisms be provided in a PSPOA based standard.

Customer

21. Although the term ‘customer’ is used frequently throughout existing IPSAS it has never been defined or explained in the context of the public sector. Customer is defined in IFRS 15 as:

‘A party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration’.

Prior to the issuance of IFRS 15, customer had also not been defined in the suite of IFRS.
22. Although not implicitly stated, this definition may be interpreted as it is the customer that receives the goods or services – that is there are only two parties within the arrangement. However, in the public sector there are often three parties within an arrangement – a customer (resource provider) contracts

³ One respondent to the CP disagreed with this as an enforceability mechanism.

with an entity (resource recipient) to provide goods or services (resources) to a third party (beneficiary).

23. Therefore, staff recommends that guidance highlighting this arrangement be provided and suggests the following guidance (or something similar) on ‘customer’ be included in a PSPOA based standard.

A ‘customer’ within a public sector transaction is not necessarily the entity that receives goods or services in exchange for consideration but rather can include an entity that provides consideration and directs the goods and services to be provided to another party.

For example: A central government provides funding to a regional health department to conduct a bone density screening program for residents over the age of 55. The central government remains the customer even though it is the residents that are receiving the goods or services from the transaction.

Commercial substance

24. IFRS 15 paragraph 9(d) requires a contract to have ‘commercial substance’, which while not defined is explained as ‘the risk, timing or amount of the entity’s future cash flow is expected to change as a result of the contract’.

25. Paragraphs BC40-41 of IFRS 15 explains commercial substance further:

BC40 The boards decided to include ‘commercial substance’ as a criterion when they discussed whether revenue should be recognised in contracts with customers that include non-monetary exchanges. Without that requirement, entities might transfer goods or services back and forth to each other (often for little or no cash consideration) to artificially inflate their revenue. Consequently, the boards decided that an entity should not recognise revenue from a non-monetary exchange if the exchange has no commercial substance.

BC41 The boards decided to describe commercial substance in paragraph (d) of IFRS 15 in a manner that is consistent with its existing meaning in other financial reporting context, such as existing requirements for non-monetary exchange transactions. The boards also observed that this criterion is important in all contracts (not only non-monetary exchanges) because without commercial substance it is questionable whether an entity has entered into a transaction that has economic consequences. Consequently, the boards decided that all contracts should have commercial substance before an entity can apply the other requirements in the revenue recognition model.

26. Commercial substance is already included in IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant and Equipment*. Both Standards have the following text regarding ‘commercial substance’

An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows or service potential is expected to change as a result of the transaction. An exchange transaction has commercial substance if:

- (a) The configuration (risk, timing, and amount) of the cash flows or service potential of the asset received differs from the configuration of the cash flows or service potential of the asset transferred: or
- (b) The entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanges.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows, if tax applies. The result of these analyses may be clear without an entity having to perform detailed calculations.

- 27. Staff note that this text is essentially the same as that contained in IAS 16, *Property, Plant and Equipment* and IAS 40, *Investment Property* but with 'service potential' included to indicate that it may be an entity's service potential that is expected to change rather than its cash flows.
- 28. Staff consider that whether a transaction is 'exchange' or 'non-exchange' is not a necessary basis of evaluating as if a transaction has 'commercial substance' but rather that the entity's cash flows or service potential will be affected by the transaction and that 'commercial substance' is akin to a transaction having economic consequences or economic substance.
- 29. Therefore staff recommend that for the purposes of the PSPOA 'or service potential' is added when commercial substance is described.

the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows <u>or service potential</u> is expected to change as a result of the contract)

Questions for the Board

- 30. Regarding Step 1 of the PSPOA, does the Board agree with the following staff recommendations re:
 - (a) Contract – 'or other binding agreement' should be added when the term 'contract' is used (paragraph 11);
 - (b) Binding agreement – a definition of binding agreement, similar to that in IPSAS 35, should be included in a proposed IPSAS (paragraph 13);
 - (c) Non legally binding enforcement mechanisms (paragraph 20);
 - (d) Including guidance on 'customer' (paragraph 23);
 - (e) Wording of guidance on 'customer' (paragraph 23);
 - (f) The addition of 'or service potential' to the description of 'commercial substance' (paragraph 29)?

Step 2 – Identify Performance Obligations

- 31. The second step in the IFRS 15 model is to identify the performance obligations. This is articulated in paragraph 22 of IFRS 15 as:

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) A good or service (or a bundle of goods or services) that is distinct; or
- (b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

32. Two key features of identifying performance obligations are:

- (a) The identification of distinct goods or services; and
- (b) The transfer to the customer.

Distinct

33. The requirement for a good or service to be 'distinct' is to enable the determination of when a performance obligation has been satisfied. Each distinct good or service within a contract needs to be identified separately from other goods or services and then accounted for separately.

34. A good or service is distinct if both of the following criteria are met:

- (a) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract) (IFRS 15 paragraph 27).

35. If goods or services are not distinct, IFRS 15 paragraph 30 requires an entity to combine goods or services with other promised goods or services until there is an identifiable bundle of goods or services that is distinct. This bundling may result in an entity accounting for all the goods or services promised in a contract as a single performance obligation. This bundling of agreed services might result in delayed recognition.

36. In extending Step 2 for the PSPOA, it is necessary to determine when promises to deliver services in the public sector are considered distinct in a binding arrangement to enable identification of performance obligations and to assess when performance obligations have been fulfilled.

37. As noted in the CP identifying distinct goods or services in the public sector can be challenging because:

- (a) The specificity of services may be implied rather than explicit states;
- (b) The specificity of services expected to be delivered may be reflected across a number of documents and mechanisms, which when combined represent a binding arrangement.

38. The CP noted that in 'determining whether promises to deliver services are distinct, an entity would need to consider the nature, cost, value or volume to determine if performance obligations could be identified' and further commented that 'determining when there is a performance obligation will often require a greater level of judgement in the public sector than for for-profit transactions'.

39. Because there may be difficulty in determining distinct goods or services to be identified as performance obligations in the public sector, the Australian Accounting Standards Board (AASB) added an extra criteria in that 'A necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is *sufficiently specific* [emphasis added] to be able to determine when the obligation is satisfied.
40. Although 'specifically specific' is not defined, paragraph F20⁴ of AASB 15, *Revenue from Contracts with Customers* states:
- Judgement is necessary to assess whether a promise is sufficiently specific. Such judgement takes into account any conditions specified in the arrangement, whether explicitly or implicit, regarding the promised goods or services, including conditions regarding the following aspects:
- (a) the nature or type of the goods or services;
 - (b) the cost or value of the goods or services;
 - (c) the quantity of the goods or services; and
 - (d) the period over which the goods or services must be transferred.
41. The AASB's Basis for Conclusions explains further –
- AASB BC38 – Some transfers of assets to not-for-profit entities are provided with no, or minimal, terms and conditions regarding how the transferred assets must be used other than that the assets are used for purposes consistent with the entity's service-delivery objectives as set out in its constitution or enabling legislation (where applicable). ... Some other transfers to not-for-profit entities are provided solely on condition that the funds are to be expended within a specified time period. For these reasons, it can be difficult to distinguish goods or services provided to meet this general requirement from any of the not-for-profit entity's other goods or services provided.
- AASB BC 39 – The circumstances described in paragraph BC38 are much more prevalent in the not-for-profit sector than the for-profit sector, and may raise issues regarding which terms and conditions attached to assets transferred to a not-for-profit entity give rise to performance obligations. The Board decided to propose a principle [in ED260] that to qualify as a performance obligation, a not-for-profit entity's enforceable promise to transfer goods or services must be sufficiently specific to allow the entity to determine when the performance obligation is satisfied, as this indicates the transfer of goods or services is not at the discretion of the provider.
42. Staff are of the view that it may not be necessary to add an extra criteria like 'sufficiently specific' but rather that guidance, drawing on the text in the CP and similar to that provided by the AASB (i.e. addressing nature cost, value or volume of delivery of services in a binding arrangement), on how to determine whether a promise is distinct will be necessary.
43. Therefore staff recommend retaining the criteria 'distinct' when developing any PSPOA based standard but that guidance be provided on whether goods and services are 'distinct'.

⁴ AASB not-for-profit guidance to AASB 15 is provided as Appendix A to this paper.

Transfer

44. The second feature of a performance obligation is the requirement that goods and services have to be transferred to a customer. For many public sector transactions this will not be problematic because although goods and services may not go to the customer directly they may be directed to a third party on behalf of the customer therefore the requirement to 'transfer' is fulfilled.
45. However, for some public sector transactions, in particular capital grants and some research grants, there will be no transfer to the customer or a third party. For example with a capital grant from a Central Government to a Local Authority to construct a community health center, the funds are provided to the Local Authority who builds the health center but upon completion, there is no transfer back to the Central Government. Therefore, these types of transactions would be outside the scope of a PSPOA.
46. Some respondents to the CP suggested that the definition of a performance obligation be expanded to capture more than transactions that involve a transfer of goods or services to capture such grants, but staff note that *The Framework* at BC5.26 states:
- A performance obligation is an obligation in a contract or other binding arrangement between an entity and an external party to transfer a resource to that other party.
47. Consequently, to expand a performance obligation beyond a transfer would be contrary to *The Framework* (albeit a Basis for Conclusions paragraph), therefore staff do not recommend expanding the definition of a performance obligation beyond that of the requirement to transfer goods and services.

Questions for the Board

Regarding Step 2 of the PSPOA, does the Board agree with the following staff recommendations:

- (a) Providing guidance on 'distinct' good and services (paragraph 43);
- (b) Maintaining the 'transfer' requirement in the definition of a performance obligation (paragraph 47)?

Step 3 – Determine the transaction price⁵

48. IFRS 15 requires revenue to be recognized as and when a performance obligation is satisfied. The amount of revenue recognized is the amount of the transaction price that is allocated to that performance obligation. Transaction price is defined as:
- The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.
49. To determine the transaction price, paragraph 47 of IFRS 15 states:
- An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for

⁵ As proposed in the CP 'transaction price' will be changed to 'consideration' for a PSPOA based standard.

transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

50. Staff consider that this step does not need much modification for use in a PSPOA because if a performance obligation is distinct and the nature, cost, value and volume are identified then the transaction price for each performance obligation should follow.
51. However, one complication that was addressed in the AASB's guidance is when a contract agreement as a dual purpose. For example the transaction may be a combination of a transfer of goods and services but may also contain a donation from the customer to the resource recipient. In these circumstances it will be necessary to allocate the transaction price appropriately. Whilst these types of transactions may not be common in the public sector - particularly with a donation component (the AASB guidance covers both the private and public not-for-profit sectors) there may be agreements that contain both specific and non-specific grants in which the transaction prices may need to be separated.
52. As a consequence of these hybrid transactions, staff recommend that guidance with illustrative examples will be required for any future ED on the PSPOA.

Question for the Board

53. Does the Board agree that guidance on hybrid/ mixed transaction agreements will be required if and when an ED on the PSPOA is developed (paragraph 52)?

Step 4 – Allocate the transaction price⁵

54. IFRS 15 paragraph 73 states that the objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.
55. Paragraph 74 (of IFRS 15) suggests that to meet this allocation objective an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price.
56. IFRS 15 provides detailed guidance on determining a stand-alone selling price but suggests that the best evidence is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
57. However, in the public sector due to the integrated nature of services stand-alone selling prices may be difficult to identify. Also because many public sector entities do not compete with private sector entities it may not be able to set prices based on market considerations.
58. To overcome this difficulty in identifying a stand-alone selling price, the CP suggests that many public sector entities receive consideration in exchange for the fulfillment of performance obligations, therefore it may be appropriate to place less emphasis on determining stand-alone selling prices and instead focus on an entity's ability to determine the cost of fulfilling each performance obligation, as a basis for allocating the total amount of agreed consideration to each performance obligation. Staff consider that this could be akin to bundling of promises to create a performance obligation.

59. Staff are of the view because of the difficulties that may be encountered with determine stand-alone selling prices staff consider the following methods may be viable to use when allocating a transaction price
- (a) Bundling (as described above in paragraph 58;
 - (b) Cost or proportionate to cost;
 - (c) Straight line (i.e. if the promise of goods and services are of a similar nature – e.g. vaccinations).
60. Staff recommend that guidance on these methods will be required for any future ED on the PSPOA.

Question for the Board

61. Does the Board agree that guidance on allocating a transaction price be required if and when an ED on the PSPOA is developed (paragraph 60)?

Step 5 – Recognize revenue

62. IFRS 15 requires revenue to be recognized as or when an entity satisfies performance obligations. This can be at a point in time (generally for goods) or over time (e.g. for services). The amount of revenue recognized is the amount allocated to the fulfilled performance obligation.
63. Staff are of the view that there are no specific public sector revenue recognition issues and how and when revenue is recognized will rely on the ability of the resource recipient to determine when a performance obligation has been fulfilled. An entity's ability to make this determination will be enhanced by the provision of clear and explicit guidance (together with examples) on the preceding four steps.
64. Therefore staff recommend that guidance will not be required for Step 5 – Recognize Revenue.

Question for the Board

65. Does the Board agree that guidance on recognizing revenue will not be required if and when an ED on the PSPOA is developed (paragraph 64)?

Agenda Item 9.2.1

Appendix A

AASB Not-for-profit Implementation Guidance to AASB 15, *Revenue from Contracts with Customers*

The following is an Appendix to AASB 15, *Revenue from Contracts with Customers*, (which is the equivalent to IFRS 15). This AASB guidance is an integral part of AASB 15 and has the same authority as other parts of the Standard. The guidance applies only to not-for-profit entities (including the public sector) when applying AASB 15.

It provides extensive guidance on how IFRS 15 can be applied to not-for-profit transactions and may be a useful reference for staff when developing a PSPOA based standard.

Introduction

- F1 AASB 15 Revenue from Contracts with Customers incorporates International Financial Reporting Standard IFRS 15 Revenue from Contracts with Customers, issued by the International Accounting Standards Board. Consequently, the text of AASB 15 is generally expressed from the perspective of for-profit entities in the private sector. The AASB has prepared this appendix to explain and illustrate the principles in the Standard from the perspective of not-for-profit entities in the private and public sectors, particularly to address circumstances where a for-profit perspective does not readily translate to a not-for-profit perspective. The appendix does not apply to for-profit entities or affect their application of AASB 15.
- F2 AASB 15 provides guidance on the following five elements of a contract with a customer:
 - (a) identifying a contract (paragraphs 9–21);
 - (b) identifying performance obligations (paragraphs 22–30);
 - (c) determining the transaction price (paragraphs 46–72);
 - (d) allocating the transaction price to performance obligations (paragraphs 73–90); and
 - (e) recognising revenue (paragraphs 31–45).
- F3 This appendix should be read in conjunction with the requirements of this Standard.
- F4 This appendix provides guidance to assist not-for-profit entities to determine whether particular transactions or other events, or components thereof, are within the scope of this Standard, in particular in relation to identifying a contract and identifying performance obligations. If a transaction is outside the scope of this Standard, the recognition and measurement of income arising from the transaction may instead be specified by another Standard, for example AASB 1058 Income of Not-for-Profit Entities.

Identifying whether a contract with a customer exists

- F5 A contract is an agreement between two or more parties that creates enforceable rights and obligations. If a not-for-profit entity's promise to transfer a good or service is made in an unenforceable arrangement with another party, a contract with a customer does not exist. If a not-for-profit entity's promise to transfer a good or service in an arrangement with another party fails the

‘sufficiently specific’ criterion discussed in paragraphs F20–F26, a contract with a customer does not exist and the entity shall not treat the promise as a performance obligation in a contract with a customer. Where a contract with a customer does not exist, the not-for-profit entity shall consider whether AASB 1058 is applicable.

Customer

- F6 In contracts with customers, the ‘customer’ is the party that promises consideration in exchange for goods or services that are an output of the entity’s ordinary activities. However, in contracts with customers in any sector, the customer might that direct goods or services are to be provided to third-party beneficiaries (including individuals or the community at large) on the customer’s behalf. In these contracts:
- (a) the customer remains the party that has contracted with the entity for those goods or services and promises consideration in exchange for those goods or services; and
 - (b) the provision of goods or services to third-party beneficiaries is a characteristic of the promised transfer of goods or services to the customer.
- F7 For example, a not-for-profit entity in the private sector may receive consideration from a government for the specified purpose of providing first-aid training free of charge to members of the community. The government is the customer because it has contracted the entity to provide the first-aid training services. This conclusion is not affected by the fact that the government specifies that those services are to be provided to members of the community.

Contract

- F8 In relation to the definition of ‘contract’ in Appendix A, the reference to an ‘agreement’ in that definition shall be read by not-for-profit entities as encompassing an arrangement entered into under the direction of another party (for example, when assets are transferred to an entity with a directive that they be deployed to provide specified services).
- F9 Paragraph 10 states that contracts can be written, oral or implied by an entity’s customary business practices. The customary business practices of a not-for-profit entity refer to that entity’s customary practice in performing or conducting its activities.

Enforceable Agreement

- F10 An inherent feature of a contract with a customer is that the entity makes promises in an agreement that creates enforceable rights and obligations. Paragraphs F11-F18 provide guidance for not-for-profit entities on when an agreement creates enforceable rights and obligations.
- F11 An agreement is enforceable when a separate party is able to enforce it through legal or equivalent means. It is not necessary for each promise in the agreement to transfer goods or services to be enforceable by legal or equivalent means, as long as some enforceable obligations of the entity arise from the agreement. For an agreement to be enforceable by a separate party through ‘equivalent means’, the presence of a mechanism outside the legal system that establishes the right of a separate party to oblige the entity to act in a particular way or be subject to consequence is required.
- F12 An agreement typically is enforceable by another party through legal or equivalent means if the agreement is in writing and includes sufficiently specific requirements of the parties. Oral agreements

also may be enforceable. Enforceability needs to be considered in relation to both the particular terms of an agreement and any additional terms agreed by the parties as a result of further discussions or actions. Examples of terms that result in enforceable agreement include the following:

- (a) a refund in cash or kind is required when the agreed specific performance has not occurred;
- (b) the customer, or another party acting on its behalf, has a right to enforce specific performance or claim damages;
- (c) the customer has the right to take a financial interest in assets purchased or constructed by the entity with resources provided under the agreement;
- (d) the parties to the agreement are required to agree on alternative uses of the resources provided under the agreement; and
- (e) an administrative process exists to enforce agreements between sovereign States or between a State and another party.

- F13 A sufficiently specific, written agreement can be enforceable even if the particular terms do not include refund or other enforcement provisions, since Australian law generally provides remedies of specific performance or damages for breach of an agreement. Agreements that explicitly state they are not intended to be legally binding may nonetheless become enforceable agreements if the parties act in a manner that is inconsistent with the stated intention. Agreements that lack elements of a contract may nonetheless become legally enforceable if there is conduct by one party that causes the other party to act in reliance on such conduct. The enforceability of agreements does not depend on their form. For example, documents such as Memoranda of Understanding, Heads of Agreement and Letters of Intent can constitute legally enforceable agreements; a formal contract is not required.
- F14 In respect of not-for-profit entities, enforcement mechanisms may arise from administrative arrangements or statutory provisions. An example of such an enforcement mechanism is a directive given by a Minister or government department to a public sector entity controlled by the government to which the Minister or government department belongs. The ministerial authority to require a transfer of goods or services would be sufficient for an agreement to be enforceable by a separate party through legal or equivalent means.
- F15 In relation to paragraph F11, a consequence for failing to transfer promised goods or services could be either a return of consideration or a penalty for non-performance that is sufficiently severe to compel the entity to fulfil its promise to transfer goods or services. In some circumstances, where rights to specific performance are unavailable or unnecessary, the authority to require compensation may be the key determinant of the enforceability of an agreement involving a promise to transfer goods or services. A capacity to impose a severe penalty for non-performance can exist without a capacity to require a return of transferred assets or assets of equivalent value.
- F16 Identification of an agreement as being enforceable by another party through legal or equivalent means does not require a history of enforcement of similar agreements by the customer or even an intention of the customer to enforce its rights. A customer might choose not to enforce its rights against an entity. However, that decision is at the customer's discretion, and does not affect the enforceability of the customer's rights. Enforceability depends solely on the customer's capacity to enforce its rights.

- F17 In contrast to the factors in paragraph F11, the following circumstances would not, of themselves, cause an agreement involving a promise to transfer goods or services to be enforceable by another party through legal or equivalent means:
- (a) a transferor has the capacity to withhold future funding to which the entity is not presently entitled; and
 - (b) a not-for-profit entity publishes a statement of intent to spend money or consume assets in particular ways. The statement of intent is generally in the nature of a public policy statement, and does not identify parties who could enforce the statement. Such a statement of intent would, of itself, be insufficient to create an enforceable agreement, even if that statement is the subject of budget-to-actual reporting and of other oversight mechanisms to discharge accountability for the raising of funds, expenditure or consumption of assets. This is in contrast to a letter of intent which is typically an agreement between specifically identified parties. See also paragraph Aus26.1 of AASB 137 [*Provisions, Contingent Liabilities and Contingent Assets*].⁶
- F18 In relation to paragraph F17(a), a transferor's capacity to withhold future funding to which the entity is not presently entitled can be distinguished from circumstances in which a transferor resents hold refund rights, or has the capacity to impose a severe penalty, in the event of the transferee's non-performance, but might choose to obtain such a refund or impose such a penalty by deducting the amount of the refund or penalty from a future transfer to the entity. For example, a transferor's capacity to withhold future funding to which the transferee is not presently entitled would differ from circumstances in which a transferor could demand a refund of granted assets in the event of the transferee's non-performance, regardless of whether it makes any future transfers to the transferee, but chooses for convenience to deduct the refund amount from a future transfer. In this latter case, the transferor could enforce against the entity a promise to provide goods or services.

Commercial Substance

- F19 Paragraph 9(d) specifies that the Standard applies to a contract with a customer only if (among other criteria) 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). A contract may have 'commercial substance', for the purposes of paragraph 9(d), even if it is entered into by a not-for-profit entity for purposes that, in everyday language, would be considered 'non-commercial' (for example, contracts to provide goods or services to members of the community on a subsidized or cost-recovery basis). This is because contracts to provide goods or services without generating a commercial return may

⁶ Aus26.1 of AASB 137 states: This paragraph and paragraph Aus26.2 relate to the recognition by a local government, government department or government of a liability arising from a local government or government existing public policy, budget policy, election promise or statement of intent. The intention to make payments to other parties, whether advised in the form of a local government or government budget policy, election promise or statement of intent, does not of itself create a present obligation which is binding. A liability would be recognised only when the entity is committed in the sense that it has little or no discretion to avoid the sacrifice of future economic benefits. For example, a government does not have a present obligation to sacrifice future economic benefits for social welfare payments that might arise in future reporting periods. A present obligation for social welfare payments arises only when entitlement conditions are satisfied for payment during a particular payment period. Similarly, a government does not have a present obligation to sacrifice future economic benefits under multi-year public policy agreements until the grantee meets conditions such as grant eligibility criteria, or has provided the services or facilities required under the grant agreement. In such cases, only amounts outstanding in relation to current or previous periods satisfy the definition of liabilities

nonetheless cause a change in the risk, timing or amount of the not-for-profit entity's future cash flows. Accordingly, for the purposes of application of the Standard by not-for-profit entities, 'commercial substance' shall be read as a reference to economic substance (i.e. giving rise to substantive rights and obligations).

Identifying whether a performance obligation exists

- F20 Paragraphs 22 and 30 of AASB 15 require that to enable an entity to identify the performance obligations that it should account for separately, each promise to transfer goods or services needs to be distinct – individually, or if not individually, as a bundle combined with other promises. The specificity of the promise to transfer goods or services can be quite different in the for-profit and not-for-profit sectors. A necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is sufficiently specific to be able to determine when the obligation is satisfied. Judgement is necessary to assess whether a promise is sufficiently specific. Such judgement takes into account any conditions specified in the arrangement, whether explicit or implicit, regarding the promised goods or services, including conditions regarding the following aspects: (a) the nature or type of the goods or services; (b) the cost or value of the goods or services; (c) the quantity of the goods or services; and (d) the period over which the goods or services must be transferred.
- F21 In the not-for-profit context, a service can include an arrangement whereby one entity undertakes specific activities on behalf of another entity. Activities may include service delivery, research or asset management, among others. However, 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, research activities undertaken to develop intellectual property that the entity will license to a customer are not themselves a transfer of goods or services to the customer.
- F22 Whether a promise is sufficiently specific so as to qualify as a performance obligation is assessed separately for each promise and will depend on the facts and circumstances. No specific number or combination of the conditions noted in paragraph F20 need to be specified in an agreement for the promise to be sufficiently specific. In addition, there may be other conditions that need to be taken into account in applying the judgement above that may indicate the promise is sufficiently specific.
- F23 Conditions specified regarding the promised goods or services may be explicit or implicit in an agreement. Paragraph 24 states that the performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer. A not-for-profit entity may make a statement of intent to spend a transfer in a particular way. As noted in paragraph F17(b), a statement of intent alone is generally not enough to create a performance obligation. Some element of the contract will need to be enforceable and past practice would need to support the customer expectation.
- F24 In relation to paragraph F20(d), a condition that a not-for-profit entity must transfer unspecified goods or services within a particular period does not, of itself, meet the 'sufficiently specific' criterion. For example, a not-for-profit entity may provide a number of services under its charter such as counselling and housing to disadvantaged youth. Where it receives a transfer to be used for an unspecified purpose over a particular time period, such a promise would not meet the 'sufficiently specific' criterion.

- F25 Some not-for-profit entities have a single purpose charter, such as to provide counselling services. However, it is unlikely that an entity's charter or stated objectives would be specific enough to require the recognition of contract liabilities under a contract that provided the entity with a grant for a specified period of time but did not also adequately identify the goods or services to be provided to other parties. Where entities receive a transfer to be used over a particular time period for specified services, such a transfer could meet the 'sufficiently specific' criterion. Specifying the services to be provided under the arrangement and the stipulation to use the transferred funds over a particular time period enables a determination of when the services have been provided. However, if the transfer does not specify the period over which the entity must use the funds or the services to be provided (such as the number of counselling sessions), the entity would not meet the 'sufficiently specific' criterion because it would be unable to determine when it meets the performance obligations.
- F26 An agreement may include a condition that the entity undertakes an acquittal process to demonstrate progress toward transferring goods or services. For example, the terms of an agreement may require the entity to report on progress toward specified outputs or outcomes in an acquittal process. Such an acquittal process may provide evidence of a promise to transfer goods or services that is sufficiently specific, depending on the requirements of the acquittal process and other facts and circumstances. An acquittal process may also enable a determination of progress toward satisfaction of the performance obligation.
- F27 Where a contract provides a transfer of a financial asset for an entity to acquire or construct a non-financial asset (e.g. a building or an intangible asset) that is to be controlled by the entity, the contract does not establish rights and obligations for the transfer of the non-financial asset to the transferor or other parties. Accordingly, the contract is not a contract with a customer, and hence is not accounted for in accordance with AASB 15. Such contracts are instead accounted for in accordance with paragraphs 15–17 of AASB 1058. In this case, the transferor has made an in-substance transfer of the non-financial asset to the entity. The entity would retain control of the non-financial asset and use it in its operations, such as to produce goods or services for transfer to other parties under other contracts. A contract to transfer a financial asset for an entity to acquire or construct a non-financial asset that is to be controlled by the entity may be part of a contract that includes other conditions that give rise to performance obligations that require the entity to transfer goods or services to other entities. Those performance obligations are accounted for under AASB 15.

Allocating the transaction price to performance obligations

- F28 A customer may enter into a contract with a not-for-profit entity with a dual purpose of obtaining goods or services and to help the not-for-profit entity achieve its objectives. An entity shall allocate the transaction price to each performance obligation so that the performance obligation allocation depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. This is based on the rebuttable presumption that the transaction price is treated as wholly related to the transfer of promised goods or services.
- F29 The presumption is rebutted where the transaction price is partially refundable in the event the entity does not deliver the promised goods or services.
- F30 Where the presumption is rebutted, the entity shall disaggregate the transaction price and account for the component that relates to the transfer of promised goods or services in accordance with this Standard. The remainder of the transaction price shall be accounted for in accordance with AASB 1058. Whether the element not related to the performance obligation is material, and therefore needs

to be accounted for separately, shall be assessed in relation to the individual contract, without reassessment at an aggregate or portfolio level.

F31 To disaggregate the component that relates to the promised goods or services, the following may be indicative of an element that is not related to the promised goods or services (and more likely to be for the purpose of enabling the not-for-profit entity to further its objectives):

(a) a non-refundable component of the transaction price; and

(b) where the entity has the status of a deductible gift recipient – the donor can claim part of the transaction price as a tax deduction for a donation.

F32 For example, a not-for-profit heritage foundation sells on-line subscriptions that provide access for a year to particular heritage sites (a promised service to each customer) and invites subscribers to, in addition, donate a non-refundable nominated amount to generally assist the foundation in pursuing its mission. Such a donation, which is voluntary for a subscriber, is separately identifiable from the price of the annual subscription. However, if the annual subscription fee and the donation were both refundable if access were not provided for the entire subscription period, the presumption in paragraph F28 could not be rebutted as the transaction price is refundable in full. In that case, the donation amount would not be accounted for separately but would be included in the transaction price that is allocated to the performance obligation to provide membership access. Consequently, the donation amount would be recognised as revenue when (or as) performance obligations under the arrangement are satisfied in accordance with AASB 15. Similarly, if both elements were equally proportionately refundable to acknowledge access already provided during the year, or if neither element were refundable, then no separation is required as the presumption is not rebutted.

Agenda Item

9.2.2

Illustrative Examples

Example 1 – General Operating Grant

(Revenue transaction with no performance obligations or stipulations over use)

Fact Pattern

- A Central Government agrees to provide a general operating grant of CU 400,000 to a Local Government Entity.
- There are no specifications on how or when the grant should be consumed.
- The Central Government has no enforcement mechanisms available to require the local government entity to consume the funding in a specific manner.
- The Local Government budgets for the CU 400,000 to be used to fund specific salary costs for the four years following the receipt of the first grant payment.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- There are no specifications as to how the grant should be used. Therefore there are no distinct goods or services to be transferred.
- **Therefore there are no performance obligations.**

Accounting treatment

- Revenue is recognized when the Local Government Entity controls the expected inflow of resources.
- **This transaction would be accounted for under an updated IPSAS 23.**

Example 2 – General Operating Grant

(Revenue transaction with time-based requirements)

Fact Pattern

- A Central Government agrees to provide a general operating grant of CU 400,000 to a Local Government Entity.
- The grant is required to be consumed over the four-year period following the Grant Agreement being agreed to by both parties.
- There are no other specifications on how the grant should be consumed.
- The Central Government has no enforcement mechanisms available to require the Local Government Entity to consume the funding on specific activities.
- The Local Government Entity budgets for the CU 400,000 to be used to fund specific salary costs for the four years following the receipt of the first grant payment.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is made at the beginning of each financial year

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- There are no specifications as to how the grant should be used other than it is required to be consumed over a four-year period. Therefore there are no distinct goods or services to be transferred.
- **Therefore there are no performance obligations.**

Accounting treatment

- Revenue is recognized when the Local Government Entity controls the expected inflow of resources.
- **This transaction would be accounted for under an updated IPSAS 23.**

Example 3 – Grant for funding of salary cost

(Revenue transaction with consumption-based stipulations and no enforcement mechanisms)

Fact Pattern

- A Central Government agrees to provide an operating grant of CU 400,000 to a Local Government Entity.
- The grant is provided to fund specified salary costs over the four years following the Grant Agreement being agreed to by both parties.
- The Central Government has no enforcement mechanisms available to require the Local Government Entity to consume the funding as specified.
- The Local Government Entity budgets for the CU 400,000 to be used to fund the specific salary costs for the next four years.
- The Local Government Entity is required to submit to the Central Government annual financial statements, including information detailing salary costs incurred in the year.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is to be made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- The grant is to fund a specific salary for four years, however there is no transfer of goods or services to the Central Government or to third party beneficiaries.
- **Therefore there are no performance obligations.**

Accounting treatment

- Revenue is recognized when the Local Government Entity controls the expected inflow of resources.
- **This transaction would be accounted for under an updated IPSAS 23.**

Example 4 – Grant for funding of salary cost

(Revenue transaction with consumption-based stipulations and with enforcement mechanisms)

Fact Pattern

- A Central Government agrees to provide an operating grant of CU 400,000 to a Local Government Entity.
- The grant is provided to fund specified salary costs over the four years following the Grant Agreement being agreed to by both parties.
- The Central Government has an enforcement mechanisms which requires the Local Government Entity to consume the funding as specified.
- The enforcement mechanism is in the form of a requirement of the Local Government Entity to return the funding if is not used as specified.
- The Local Government Entity budgets for the CU 400,000 to be used to fund the specific salary costs for the next four years.
- The Local Government Entity is required to submit to the Central Government annual financial statements including information detailing salary costs incurred in the year.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is to be made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity to consume the funding as specified.
- Both parties have agreed to the arrangement.
- The Central Government is the customer.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant is to fund a specific salary for four years, however there is no transfer of goods or services to the Central Government or to third party beneficiaries.
- **Therefore there are no performance obligations.**

Accounting treatment

- Revenue is recognized when the Local Government Entity controls the expected inflow of resources.
- **This transaction would be accounted for under an updated IPSAS 23.**

BOARD DISCUSSION

Would the decision regarding whether or not there is a transfer of goods and service change depending on the type of employee's salary the grant funded? For example administrative to support the general running of the Local Government Entity or Doctor/Teacher etc. who provides services to external beneficiaries.

Example 5 – Grant to provide mental health services

(Revenue transaction involving a transfer of goods or services to beneficiaries)

Fact Pattern

- A Central Government agrees to provide a grant of CU 100,000 to a Local Government Entity.
- The grant is to fund mental health counselling services to inmates at a prison.
- The number of hours of counselling services to be provided is not specified, however a minimum of CU 100,000 in value must be provided.
- The provider of the counselling services must be an accredited mental health provider and comply with industry codes of ethics.
- The local government is required to report back each month to the Central Government on the hours of counselling services provided for that month.
- The Central Government has an enforcement mechanisms which requires the Local Government Entity to consume the funding as specified on counselling services.
- A CU 100,000 payment is to be made by the Central Government to the Local Government Entity at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity to consume the funding as specified – mental health counselling services to prison inmates
- Both parties have agreed to the arrangement.
- The Central Government is the customer.
- The prison inmates are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant requires the transfer of counselling services to beneficiaries in exchange for CU 100,000.
- This is a transfer of a distinct service.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The Local Government Entity expects to receive CU 100,000 in exchange for providing the counselling services.
- **Therefore the consideration is CU 100,000.**

Step 4 – Allocate the consideration

- It would be appropriate to allocate the consideration based counsellor's hourly rate.
- **Therefore the consideration is allocated on the basis of the counsellor's hourly rate.**

Step 5 – Recognize revenue

- **Revenue is recognized at the counsellors number of hours x hourly rate**

Accounting treatment

- Revenue is recognized when the Local Government Entity satisfies the performance obligation of providing counselling services to prison inmates
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of receipt of grant

DR Bank CU 100,000

CR Unearned Revenue	CU 100,000
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The CU 100,000 grant is transferred from the Central Government to the Local Government Entity at the beginning of the financial year. It is appropriate to recognize a liability because there are performance obligations to provide counselling services to beneficiaries that are enforceable i.e. there is a present obligation for an outflow of resources from a past event.

Subsequent recognition of revenue

DR Unearned Revenue CU XX

CR Revenue CU XX

Revenue is recognized based on the number of counselling hours x hourly rate – as these services are provided.

Example 6 – Transfer of Land

Fact Pattern

- Central Government agrees to transfer land to a Local Government Entity.
- The land is to be used for a community garden by residents within the Local Government Entity's jurisdiction. It cannot be developed or used for any other purpose.
- The Central Government has an enforcement mechanism that requires the Local Government Entity to return the land to the Central Government if it ceases to be used as community garden.
- The value of the land is CU 500,000.
- The transfer is to take place at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity use the land for a community garden.
- The Central Government is the customer.
- The Local Government Entity's residents are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The land is transferred to the Local Government Entity.
- The Local Government Entity is required to use the land as a community garden.
- However, there is no 'distinctness' associated with the land transfer (i.e. it is an open ended arrangement with no expiry)
- **Therefore there is no performance obligation**

Accounting treatment

- Revenue is recognized when the Local Government Entity controls the land.
- **This transaction would be accounted for under an updated IPSAS 23.**

Example 7 – Transfer of Land for a specific period of time

Fact Pattern

- A Central Government agrees to transfer land to a Local Government Entity.
- The land is to be used for a community garden by residents within the Local Government Entity's jurisdiction. It cannot be developed or used for any other purpose.
- The Central Government has an enforcement mechanism that requires the Local Government Entity to return the land to the Central Government if it ceases to be used as community garden.
- The land is required to be used as a community garden for 20 years after which time the ownership of the land will be retained by the Local Government Entity and the Central Government's enforcement mechanism will cease to be effective.
- The Local Government Entity is to provide evidence, to the Central Government, each year that the land is being used as a community garden.
- The value of the land is CU 500,000.
- The transfer is to take place at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity use the land for a community garden.
- The Central Government is the customer.
- The Local Government Entity's residents are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The land is transferred to the Local Government Entity.
- The Local Government Entity is required to use the land as a community garden – this is a service to the beneficiaries.
- The land is to be used as a community garden for 20 years – there is a distinct period of time that the land is to be used as a community garden.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The Local Government Entity expects to receive land to the value of CU 500,000 in exchange for making it available for use by residents as a community garden.
- **Therefore the consideration is CU 500,000.**

Step 4 – Allocate the consideration

- It would be appropriate to allocate the consideration on a straight-line basis of value / number of years.
- **Therefore the consideration is allocated on the basis $CU\ 500,000/20 = CU\ 25,000$ per year.**

Example 8 – Grant to construct a building

Fact Pattern

- A Central Government provides a grant of CU 10,000,000 to a Local Government Entity.
- The grant is to be used to construct an early childhood education facility.
- The construction period is expected to be 12 months.
- The early childhood education facility is required to be used for that purpose for 10 years.
- Any funds not spent on constructing the asset must be returned to the Central Government.
- If the Local Government Entity ceases to use the facility for early childhood education facility within the 10 years, the Central Government can demand repayment of the entire grant.
- The Central Government has enforcement mechanisms to enforce the return of the grant if the use condition is breached.
- A CU 10, 000,000 payment is to be made by the Central Government to the Local Government Entity at the beginning of the financial year.
- The Local Government Entity is required to provide the Central Government with a progress report on pre-agreed significant stages of the construction of the facility.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity return the funds if it is not spent on constructing the asset.
- The Central Government can also demand repayment of the grant if it ceases to be used as an early childhood education facility.
- The Central Government is the customer.
- The parents/children using the facility are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- There are two requirements in this agreement:
 - The building of the facility
 - There is no transfer of goods or services to the customer.
 - **Therefore there is no performance obligation.**
 - The use of the facility.
 - There is a transfer of services to the parents/children that use the facility.
 - **Therefore there is a performance obligation.**

Step 3 – Determine the consideration

- Because the Central Government can demand repayment of the full grant if the facility ceases to be used as an early childhood education facility within 10 years the consideration is the full amount of the grant.
- **Therefore the consideration is CU 10,000,000.**

Step 4 – Allocate the consideration

- The full grant is linked to the usage of the asset as an early childhood education facility therefore the consideration should be allocated as grant / number of years
- **Therefore the amount of consideration allocated each year is CU 1,000,000**

Step 5 – Recognize revenue

- **Revenue is recognized as CU 1,000,000 per year**

Accounting treatment

- Revenue is recognized when the Local Government Entity satisfies the performance obligation of using the asset as an early childhood education.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of receipt of grant

DR Bank	CU 10,000,000
CR Unearned Revenue	CU 10,000,000

A grant of CU 500,000 is transferred from the Central Government to the Local Government Entity at the beginning of the financial year. It is appropriate to recognize a liability because there are performance obligations to make the asset available for use as an early education facility. There is a present obligation for an outflow of resources from a past event.

Subsequent recognition of revenue

DR Unearned Revenue	CU 1,000,000
CR Revenue	CU 1,000,000

Revenue is recognized at CU 1,000,000 per year for 10 years providing the asset it is continued to be used as an early childhood education facility.

Board discussion

- **Should the grant be allocated between the building and the use of the facility?**
- **If so on what basis should such an allocation be made?**

Example 9 – Grant for rental of additional teaching space

Fact Pattern

- A Central Government provides a grant of CU 50,000 and to a University.
- The grant is to be used to rent extra teaching space due to an increase in student enrolments.
- The university has provided evidence to the Central Government that the required rented teaching space will cost CU 50,000. The rental agreement is initially for one year, but can be renewed by the University.
- The grant is renewable annually while the extra teaching space is required.
- The teaching space is to be used to deliver university courses to students.
- The grant is repayable if the teaching space is not used for the full university year on a pro-rata basis.
- The grant is paid at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism if the university does not use the teaching space for the full university year.
- The Central Government is the customer.
- The students using the teaching space are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant requires the University to use the teaching space to deliver course to students - this is a transfer of a distinct service.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The University expects to receive CU 50,000 in to rent teaching space for the delivery of university courses.
- **Therefore the consideration is CU 50,000.**

Step 4 – Allocate the consideration

- It would be appropriate to allocate the consideration based on the rent paid at reporting date.
- **Therefore the consideration is allocated on the basis of rent paid.**

Step 5 – Recognize revenue

- **Revenue is recognized as the amount of rent paid for the reporting period.**

Accounting treatment

- Revenue is recognized when the University satisfies the performance obligation of providing the teaching space for students.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of receipt of grant

DR Bank CU 50,000

CR Unearned Revenue CU 50,000

The CU 50,000 grant is transferred from the Central Government to the University at the beginning of the financial year. It is appropriate to recognize a liability because there are performance obligations to provide a teaching space for students that are enforceable i.e. there is a present obligation for an outflow of resources from a past event.

Subsequent recognition of revenue

DR Unearned Revenue CU XX

CR Revenue CU XX

Revenue is recognized based on the amount of rent paid at reporting date. – For example if the University provided a half yearly report the amount of revenue recognized would be CU 25,000.

Example 10 - Payment for the construction of building to house extra teaching space

- A Central Government provides payment of CU 15,000,000 to a University.
- The funds are to be used to construct a building to provide extra teaching space.
- Demographics have determined that there will be an increase in student enrolments for the next 30 years.
- The University is required to use the building as teaching space to deliver courses to students for 30 years.
- The payment of CU 15,000,000 is an interest free loan from the Central Government to the University.
- The payment of CU 15,000,000 is to be made at the beginning of the financial year.
- The Central Government writes down the loan to the value of the depreciation.
- The Central Government has enforcement mechanisms to require pro-rata repayment of the loan if the building ceases to be used as teaching space.
- The building is to be depreciated over the 30 years on a straight-line basis with no residual value.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism if the university ceases to use the building as teaching space.
- The Central Government is the customer.
- The students using the teaching space are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The University is required to use the building as teaching space to deliver course to students - this is a transfer of a distinct service.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The payment of CU 15,000,000 from the Central Government to the University is an interest free loan and not a grant. However, the writing down of the loan to the value of the depreciation is in effect a grant.
- **Therefore the University expects to receive consideration to the value of CU 15, 000.000**

Step 4 – Allocate the consideration

- The loan is written down by the value of the depreciation each year. Therefore consideration should be allocated on the same basis.
- **Therefore the consideration is allocated as CU 500,000 each year.**

Step 5 – Recognize revenue

- **Revenue is recognized as the CU 500,000 each year**

Accounting treatment

- Revenue is recognized when the University satisfies the performance obligation of providing the teaching space for students.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of receipt of funds

DR Bank	CU 15,000,000
CR Loan	CU 15,000,000

The CU 15,000,000 loan is transferred from the Central Government to the University at the beginning of the financial year.

Subsequent recognition of depreciation

DR Depreciation	CU 500,000
CR Accumulated Depreciation (Asset)	CU 500,000

Subsequent recognition of revenue

DR Loan	CU 500,000
CR Revenue	CU 500,000

Revenue is recognized based on the amount of depreciation recognized at reporting date.

Non-Exchange Expenses: Public Sector Performance Obligation Approach**Questions**

1. The IPSASB is asked to decide whether grants, contributions and other transfers that contain either performance obligations should be accounted for using the public sector performance obligation approach (PSPOA) for non-exchange expenses, and if so, provide direction to staff on the development of the PSPOA.

Detail*Background*

2. The PSPOA for revenue transactions is discussed in [Agenda Item 9.2.1](#). Decisions taken by the IPSASB in discussing the PSPOA for revenue transactions are expected to influence the use of the PSPOA for non-exchange expense transactions.
3. In the Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses*, the IPSASB included a preliminary view (PV) that, for non-exchange expenses “where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA which is the counterpart to the IPSASB’s preferred approach for revenue.”
4. The IPSASB reviewed the responses to the PV at its March 2018 meeting (at [Agenda Item 12.2.2](#)). Members may wish to refer to those papers for further information; however, the key issues can be summarized as follows:
 - (a) A majority of respondents who commented either agree or partially agree with the PV: However, the number of respondents who agree with the PV is a minority of those who commented.
 - (b) The advantages of using the PSPOA when accounting for grants, contributions and other transfers that contain either performance obligations or stipulations are as follows:
 - (i) Symmetrical accounting is easier for preparers and users to understand.
and
 - (ii) Many grants, contributions and other transfers take place between different levels of government (for example, a state government may give a grant to a municipality). Where Whole of Government Accounts (consolidated financial statements) are prepared, the consolidation will be easier if the accounting is symmetrical.
 - (c) Concerns about using the PSPOA when accounting for grants, contributions and other transfers that contain either performance obligations or stipulations fell into two broad categories:
 - (i) *Conceptual Issues*. Some respondents considered that a valid expectation on the part of the resource recipient might arise once the funding is approved, and at that point, an expense could not be avoided by the grantor (resource provider). This might be at an earlier point than the recipient would recognize revenue, as the grantor might have a present obligation as soon as the funding arrangement is agreed, but the grant recipient

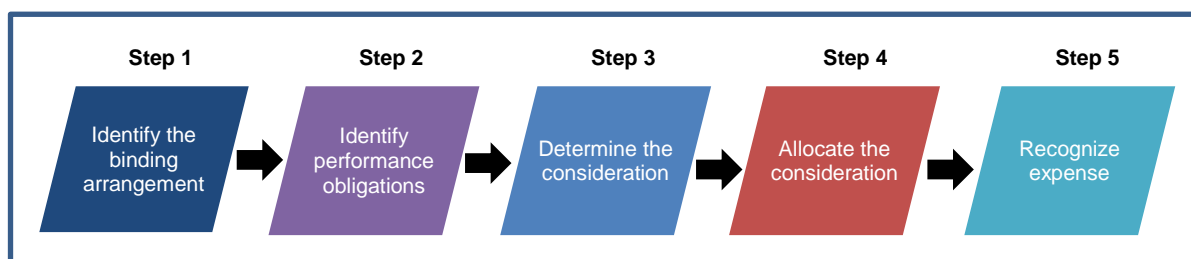
would not recognize revenue until it had satisfied performance obligations. Some respondents also questioned whether a resource provider still controls an asset that has already been transferred to a resource recipient, based only on the fact that the resource recipient has not yet fulfilled performance obligations. Some respondents commented that it cannot be assumed that the pattern of revenue recognition by the resource recipient should mirror the pattern of expense recognition by the resource provider, as different considerations may need to be taken into account.

and

- (ii) *Practical issues.* Some respondents were concerned that grantors may have difficulties in determining the extent to which a grantee has satisfied a performance obligation unless this information is periodically reported. Some commented that a platform needs to be provided for the exchange of information between resource providers and resource recipients about the results of obligations performed. Staff notes that in some jurisdictions, grant recipients are required to provide evidence of how the grant has been used, which addresses this concern.
5. This Agenda Paper discusses the conceptual issues raised by stakeholders in considering whether the PSPOA can be applied to non-exchange expenses in the same way that it is applied to revenue. To assist the IPSASB in considering this critical issue, [Appendix A](#) to this Agenda Item discusses the grantor accounting for the examples considered in discussing the application of the PSPOA to revenue transactions in [Agenda Item 9.2.2](#). If the IPSASB agrees to proceed with the PSPOA, the practical issues will need to be considered at a later meeting.

Five Steps of the PSPOA

6. The PSPOA for revenue adopts a five step approach. The CP adapted these steps for non-exchange expenses. The five steps are summarized in the diagram below:



7. The five steps for revenue are discussed in [Agenda Item 9.2.1](#). Staff considers that the issues identified in that paper will apply equally to non-exchange expenses. In particular:
- (a) For the PSPOA to be appropriate for non-exchange expenses, the grantor (resource provider) will need to have enforceable rights under a binding arrangement.
 - (b) A performance obligation should be for the transfer of goods and services, as recommended in [Agenda Item 9.2.1](#), as this would be consistent with the *Conceptual Framework's* Basis for Conclusions.

and

- (c) Non-exchange expense transactions may include components with performance obligations and elements without performance obligations. The components without performance obligations will need to be accounted for separately in accordance with an updated IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Timing of Present Obligation

8. Some stakeholders suggested that a present obligation might arise once funding is approved. This view is based on the definition of a liability in the *Conceptual Framework*:

A present obligation of the entity for an outflow of resources that results from a past event.

9. Present obligations may be legal obligations or non-legally binding obligations. Because the PSPOA requires the grantor to have enforceable rights under a binding arrangement, non-legally binding obligations are not relevant when considering the PSPOA.
10. It is likely that a legal obligation will arise once the entity has entered into a contract or binding arrangement to provide funding. Paragraph BC5.19 of the Basis for Conclusions to the *Conceptual Framework*, states that “the IPSASB accepts that a legal obligation gives rise to a present obligation.” This present obligation would arise from a past event, entering into the contract or binding arrangement.
11. This analysis suggests that an entity should recognize a liability when it enters into a contract or binding arrangement to provide funding. Unless the entity were to recognize an asset of equal value, the contra-entry to the recognition of a liability would be the recognition of a non-exchange expense. If a non-exchange expense is recognized at this point, this is likely to be at an earlier point than the grant recipient would recognize revenue under the PSPOA, as under the PSPOA the grant recipient would not recognize revenue until it had satisfied performance obligations.
12. If an asset of equal value were to be recognized, the IPSASB would need to consider the presentation approach to be applied when accounting for non-exchange expenses under the PSPOA. The alternatives would be to present both the asset and the liability, or to present the asset and liability net (which, as the asset and liability would have equal value), not presenting an asset or liability).
13. If no asset of equal value were to be recognized, staff considers that the analysis above indicates that a non-exchange expense should be recognized at the same time as the liability, when the contract or binding arrangement is entered into.
14. The possible existence of an asset of equal value is discussed below, beginning at paragraph 15.

Existence of an Asset

15. Some stakeholders questioned whether a resource provider still controls an asset that has already been transferred to a resource recipient, based only on the fact that the resource recipient has not yet fulfilled performance obligations. The *Conceptual Framework* defines an asset as:
- A resource presently controlled by the entity as a result of a past event*
16. Two elements of this definition need to be considered – whether there is a resource (and if so, what that resource is); and whether the resource is presently controlled by the entity.

Resource

17. The *Conceptual Framework* defines a resource as “an item with service potential or the ability to generate economic benefits.”
18. In discussing the application of the PSPOA to non-exchange expenses, some stakeholders have discussed the possibility of the resource being recognized in terms of the cash (or other asset) that is provided by the grantor (resource provider). Staff disagrees with this conclusion. The analysis in paragraphs 8 to 13 above indicates that a liability arises when an entity enters into a contract or binding arrangement to provide funding. In many cases, the entity will enter into the contract or binding arrangement prior to transferring the cash. The logical consequence of this is that an asset that is recognized at the same time as the liability cannot be the cash, as the entity still controls this at the point that it enters into the binding arrangement.
19. As noted in paragraph 7(b) above, staff is recommending that the performance obligation under the PSPOA is limited to the transfer of goods or services. The resource, therefore, will be the service potential embodied in those goods or services. The goods or services to be transferred will have service potential or the ability to generate economic benefits. Consequently, if the entity controls this resource (see discussion below, starting at paragraph 22) it will meet the definition of an asset.
20. In tripartite arrangements, where the grantor (resource provider) provides resources to the grant recipient to deliver goods or services to third party beneficiaries (service recipients), it is likely that the value of the goods or services to be transferred will be approximately equal to the value of the funding provided. In other cases, particularly where the goods or services are to be provided to the grantor (resource provider), the value of the goods or services may be lower than the value of the funding provided. The PSPOA can be used regardless of whether the grant and the goods or services have approximately equal value.
21. Staff acknowledges that there may be practical difficulties in measuring the goods or services to be transferred by the grant recipient. Consequently, the IPSASB may wish to consider whether it would be appropriate to include a presumption that the goods or services to be transferred to third party beneficiaries (service recipients) will have approximately equal value to the resources to be provided by the grantor (resource provider).

Control

22. Staff considers that, if there is a resource, it will be presently controlled by the entity. The *Conceptual Framework* gives four indicators of control:
 - (a) Legal ownership;
 - (b) Access to the resource, or the ability to deny or restrict access to the resource;
 - (c) The means to ensure that the resource is used to achieve its objectives; and
 - (d) The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.
23. Because the PSPOA requires the grantor to have enforceable rights under a binding arrangement, staff considers that the entity will have the means to ensure that the resource is used to achieve its objectives, which is likely to mean that it presently controls any resource.

Staff Conclusion

24. Because staff is recommending that the performance obligation under the PSPOA is limited to the transfer of goods or services (see paragraph 7(b) above), staff considers there will be a resource. Because control of a resource will also exist, this means that the entity should recognize an asset at the same time as it recognizes the liability
25. In many cases, the value of the goods or services to be provided will be of approximately equal value to the funding provided. This is likely to be the case where an entity is providing resources for a grant recipient to provide goods or services to third party beneficiaries (service recipients). In these circumstances, an entity will recognize a liability and an asset of equal value when it enters into the binding arrangement.
26. Where the value of the goods or services to be transferred is lower than the liability assumed, the liability recognized would have a greater value than the asset recognized, and a non-exchange expense for the difference would therefore be recognized on initial recognition.

Accounting for Non-Exchange Expenses using the PSPOA

27. The analysis above indicates that, under the PSPOA, an entity will recognize a liability (to provide funding) and an asset (for the service potential or economic benefits embodied in the goods or services to be transferred) when it first enters into the binding arrangement.
28. Subsequently, the entity would recognize a non-exchange expense as the grant recipient delivers the goods or services to service recipients (i.e., as the grant recipient satisfies its performance obligations). This would be the point that the entity loses control over the asset (the service potential embodied in the goods or services to be transferred) as these resources will have been transferred to the third party.
29. The entity would derecognize the liability as it transfers the funding to the grant recipient.
30. As noted in paragraph 12 above, the IPSASB will need to decide whether the liability and asset should be shown net or gross.
31. Staff notes that the proposed accounting treatment is consistent with that discussed elsewhere in IPSAS for executory contracts⁷. The general practice for executory contracts is that liabilities and assets are not presented except to the extent that one party has performed their obligations (i.e., a net presentation).
32. Staff also notes that under the proposed accounting treatment, where the value of the liability is greater than the value of the asset, the entity would recognize a non-exchange expense. This is consistent with the treatment of an onerous executory contract in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

⁷ Executory contracts are defined in IPSAS 19 as “contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent.” Executory contracts are further discussed in paragraphs BC5.4–BC5.6 of the Basis for Conclusions to the *Conceptual Framework*.

Decisions required

33. The IPSASB is asked whether grants, contributions and other transfers that contain either performance obligations or stipulations should be accounted for using the (PSPOA).
34. If the IPSASB agrees that the PSPOA should be used, the IPSASB is asked whether it agrees with staff's conclusions that:
 - (a) For the PSPOA to be appropriate for non-exchange expenses, the grantor (resource provider) will need to have enforceable rights under a binding arrangement;
 - (b) A performance obligation should be for the transfer of goods and services;
 - (c) A present obligation arises when the grantor (resource provider) enters into a contract or binding arrangement to provide funding;
 - (d) The grantor (resource provider) obtains an asset for the service potential embodied in the goods or services to be transferred by the grant recipient;
 - (e) Where the goods or services transferred have approximately equal value to the funding transferred, the entity recognizes a liability and an asset when it first enters into the binding arrangement;
 - (f) Where the goods or services transferred do not have approximately equal value to the funding transferred, the entity recognizes a liability, an asset and a non-exchange expense for the difference when it first enters into the binding arrangement;
 - (g) The grantor recognizes a non-exchange expense, and derecognizes the asset, as the grant recipient satisfies its performance obligation to transfer goods or services; and
 - (h) The grantor derecognizes the liability as it transfers the funding to the grant recipient.
35. If the IPSASB agrees that the PSPOA should be used, and that staff's conclusions are correct, the IPSASB is asked whether an ED on non-exchange expenses should adopt a net or gross presentation. Staff notes that a net presentation is adopted for executory contracts, which are the exchange expense equivalent to non-exchange expenses accounted for under the PSPOA.

Agenda Item 9.2.3

Appendix A

PSPOA Examples: Non-Exchange Expenses

The examples in this Appendix mirror those used when discussing the application of the PSPOA to revenue transactions in [Agenda Item 9.2.2](#).

Example 1 – General Operating Grant

(Revenue transaction with no performance obligations or stipulations over use)

Fact Pattern

- A Central Government agrees to provide a general operating grant of CU 400,000 to a Local Government Entity.
- There are no specifications on how or when the grant should be consumed.
- The Central Government has no enforcement mechanisms available to require the Local Government Entity to consume the funding in a specific manner.
- The Local Government Entity budgets for the CU 400,000 to be used to fund specific salary costs for the four years following the receipt of the first grant payment.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way. Binding arrangements impose specific obligations on both parties, and in this case, there are no specific obligations imposed on the Local Government Entity.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- There are no specifications as to how the grant should be used. Therefore there are no distinct goods or services to be transferred that the Central Government can control.
- **Therefore there are no performance obligations.**

Accounting treatment

- A non-exchange expense is recognized when the Central Government has a present obligation to transfer the grant.
- **This transaction would be accounted outside the PSPOA. The IPSASB has yet to decide where guidance for such transactions will be provided.**

Example 2 – General Operating Grant

(Revenue transaction with time-based requirements)

Fact Pattern

- A Central Government agrees to provide a general operating grant of CU 400,000 to a Local Government Entity.
- The grant is required to be consumed over the four-year period following the Grant Agreement being agreed to by both parties.
- There are no other specifications on how the grant should be consumed.
- The Central Government has no enforcement mechanisms available to require the Local Government Entity to consume the funding on specific activities.
- The Local Government Entity budgets for the CU 400,000 to be used to fund specific salary costs for the four years following the receipt of the first grant payment.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is made at the beginning of each financial year

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way. Binding arrangements impose specific obligations on both parties, and in this case, there are no specific obligations imposed on the Local Government Entity.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- There are no specifications as to how the grant should be used other than it is required to be consumed over a four-year period. Therefore there are no distinct goods or services to be transferred that the Central Government can control.
- **Therefore there are no performance obligations.**

Accounting treatment

- A non-exchange expense is recognized when the Central Government has a present obligation to transfer the grant.
- **This transaction would be accounted outside the PSPOA. The IPSASB has yet to decide where guidance for such transactions will be provided.**

Example 3 – Grant for funding of salary cost

(Revenue transaction with consumption-based stipulations and no enforcement mechanisms)

Fact Pattern

- A Central Government agrees to provide an operating grant of CU 400,000 to a Local Government Entity.
- The grant is provided to fund specified salary costs over the four years following the Grant Agreement being agreed to by both parties.
- The Central Government has no enforcement mechanisms available to require the Local Government Entity to consume the funding as specified.
- The Local Government Entity budgets for the CU 400,000 to be used to fund the specific salary costs for the next four years.
- The Local Government Entity is required to submit to the Central Government annual financial statements, including information detailing salary costs incurred in the year.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is to be made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has no enforcement mechanism to require the Local Government Entity to consume the funds in any particular way. Binding arrangements give rise to enforceable obligations, however in this case, the obligations imposed are not enforceable.
- **Therefore there is no binding agreement.**

Step 2 – Identify the performance obligation(s)

- The grant is to fund a specific salary for four years, however there is no transfer of goods or services to the Central Government or to third party beneficiaries. Consequently, there are no resources that the Central Government can control.
- **Therefore there are no performance obligations.**

Accounting treatment

- A non-exchange expense is recognized when the Central Government has a present obligation to transfer the grant.
- **This transaction would be accounted outside the PSPOA. The IPSASB has yet to decide where guidance for such transactions will be provided.**

Example 4 – Grant for funding of salary cost

(Revenue transaction with consumption-based stipulations and with enforcement mechanisms)

Fact Pattern

- A Central Government agrees to provide an operating grant of CU 400,000 to a Local Government Entity.
- The grant is provided to fund specified salary costs over the four years following the Grant Agreement being agreed to by both parties.
- The Central Government has enforcement mechanisms which requires the Local Government Entity to consume the funding as specified.
- The enforcement mechanism is in the form of a requirement of the Local Government Entity to return the funding if is not used as specified.
- The Local Government Entity can legally enforce the payment of the grant by the Central Government.
- The Local Government Entity budgets for the CU 400,000 to be used to fund the specific salary costs for the next four years.
- The Local Government Entity is required to submit to the Central Government annual financial statements including information detailing salary costs incurred in the year.
- Payment is to be made by the Central Government to the Local Government Entity in four CU 100,000 payments.
- Each payment is to be made at the beginning of each financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity to consume the funding as specified. The Local Government Entity can enforce the payment of the grant.
- Both parties have agreed to the terms of the arrangement.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant is to fund a specific salary for four years. However it is not clear that there is requirement that the Local Government Entity transfer services to either the Central Government or to third party beneficiaries. Consequently, it is also not clear that there are resources that the Central Government will control.
- **Therefore there are no performance obligations.**

Accounting treatment

- A non-exchange expense is recognized when the Central Government has a present obligation to transfer the grant.
- **This transaction would be accounted outside the PSPOA. The IPSASB has yet to decide where guidance for such transactions will be provided.**

IPSASB DISCUSSION

Staff's analysis suggests that there is no transfer of goods or services. Should this decision be dependent on the nature of role being funded? For example, would it be the case that an administrative role to support the general running of the Local Government Entity would not involve the transfer of goods or services to Central Government or a third party beneficiary, whereas if the role were for a doctor or teacher, this could involve the transfer of services to third party beneficiaries?

Example 5 – Grant to provide mental health services

(Revenue transaction involving a transfer of goods or services to beneficiaries)

Fact Pattern

- A Central Government agrees to provide a grant of CU 100,000 to a Local Government Entity.
- The grant is to fund mental health counselling services to inmates at a prison.
- The number of hours of counselling services to be provided is not specified, however a minimum of CU 100,000 in value must be provided.
- The provider of the counselling services must be an accredited mental health provider and comply with industry codes of ethics.
- The local government is required to report back each month to the Central Government on the hours of counselling services provided for that month.
- The Central Government has an enforcement mechanisms which requires the Local Government Entity to consume the funding as specified on counselling services.
- The Local Government Entity can legally enforce the payment of the grant by the Central Government.
- A CU 100,000 payment is to be made by the Central Government to the Local Government Entity at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity to consume the funding as specified – mental health counselling services to prison inmates. The Local Government Entity can enforce the payment of the grant.
- Both parties have agreed to the arrangement.
- The prison inmates are the beneficiaries
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant requires the transfer of counselling services to beneficiaries in exchange for CU 100,000.
- This is a transfer of a distinct service that the Central Government can control.
- **Therefore the binding arrangement includes a performance obligation**

Step 3 – Determine the consideration

- The Central Government expects to transfer CU 100,000 in exchange for the Local Government Entity providing the counselling services.
- **Therefore the consideration is CU 100,000.**

Step 4 – Allocate the consideration

- It would be appropriate to allocate the consideration based counsellor's hourly rate.
- **Therefore the consideration is allocated on the basis of the counsellor's hourly rate.**

Step 5 – Recognize expense

- **A non-exchange expense is recognized as the counsellor delivers services, calculated as the counsellor's hours x hourly rate.**

Accounting treatment

- Non-exchange expenses are recognized as the Local Government Entity satisfies the performance obligation of providing counselling services to prison inmates
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of binding arrangement

DR Asset (right to services) CU 100,000

CR Liability (grant payable) CU 100,000

Entering into a binding arrangement gives rise to a present obligation. In this case, it also gives rise to an asset of equal value, being the right to control the delivery of the agreed services.

Payment of grant

DR Liability (grant payable) CU 100,000

CR Bank CU 100,000

Subsequent recognition of non-exchange expenses

DR Non-exchange expenses CU XX

CR Asset (right to services) CU XX

Non-exchange expenses are recognized as the Local Government Entity satisfies its performance obligation by delivering the counselling services. The value of the expenses recognized will be based on the number of counselling hours x hourly rate.

Example 6 – Transfer of Land

Fact Pattern

- Central Government agrees to transfer land to a Local Government Entity.
- The land is to be used for a community garden by residents within the Local Government Entity's jurisdiction. It cannot be developed or used for any other purpose.
- The Central Government has an enforcement mechanism that requires the Local Government Entity to return the land to the Central Government if it ceases to be used as community garden.
- The Local Government Entity can legally enforce the transfer of the land by the Central Government.
- The value of the land is CU 500,000. The Central Government measures land at fair value.
- The transfer is to take place at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity use the land for a community garden. The Local Government Entity can enforce the transfer of the land.
- The Local Government Entity's residents are the beneficiaries.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The land is transferred to the Local Government Entity.
- The Local Government Entity is required to use the land as a community garden.
- The obligation imposed on the Local Government Entity will not satisfy the definition of a performance obligation, as it is an open ended arrangement with no expiry. As such, it is not possible to assess the extent to which the obligation has been satisfied. This does not provide a suitable basis for recognizing a non-exchange expense.
- **Therefore there is no performance obligation**

Accounting treatment

- A non-exchange expenses are is recognized when the Central Government has a present obligation to transfer the land.
- **This transaction would be accounted outside the PSPOA. The IPSASB has yet to decide where guidance for such transactions will be provided.**

Example 7 – Transfer of Land for a specific period of time

Fact Pattern

- A Central Government agrees to transfer land to a Local Government Entity.
- The land is to be used for a community garden by residents within the Local Government Entity's jurisdiction. It cannot be developed or used for any other purpose.
- The Central Government has an enforcement mechanism that requires the Local Government Entity to return the land to the Central Government if it ceases to be used as community garden.
- The land is required to be used as a community garden for 20 years after which time the ownership of the land will be retained by the Local Government Entity and the Central Government's enforcement mechanism will cease to be effective.
- The Local Government Entity is to provide evidence, to the Central Government, each year that the land is being used as a community garden.
- The Local Government Entity can legally enforce the transfer of the land by the Central Government.
- The value of the land is CU 500,000. The Central Government measures land at fair value.
- The transfer is to take place at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity use the land for a community garden. The Local Government Entity can enforce the transfer of the land.
- The Local Government Entity's residents are the beneficiaries.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The land is transferred to the Local Government Entity.
- The Local Government Entity is required to use the land as a community garden – this is a transfer of a service to the beneficiaries that is controlled by the Central Government.
- The land is to be used as a community garden for 20 years – there is a distinct period of time that the land is to be used as a community garden.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The Central Government expects to transfer land to the value of CU 500,000 in exchange for making it available for use by residents as a community garden.
- **Therefore the consideration is CU 500,000.**

Step 4 – Allocate the consideration

- It would be appropriate to allocate the consideration on a straight-line basis over time as this reflects the pattern of service delivery.

- **Therefore the consideration is allocated on the basis CU 500,000/20 years = CU 25, 000 per year.**

Step 5 – Recognize expense

- **Non-exchange expense are recognized yearly, at CU 25,000 per year**

Accounting treatment

- Non-exchange expenses are recognized as the Local Government Entity satisfies the performance obligation of making the land available to residents as a community garden.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of binding arrangement

DR Asset (right to services)	CU 500,000
CR Liability (obligation to transfer land)	CU 100,000

Entering into a binding arrangement gives rise to a present obligation. In this case, it also gives rise to an asset of equal value, being the right to control the delivery of the agreed services.

Transfer of land

DR Liability (obligation to transfer land)	CU 500,000
CR Property, Plant and Equipment	CU 500,000

The Central Government derecognizes the land asset when it transfers the title to the land to the Local Government Entity.

Subsequent recognition of non-exchange expenses

DR Non-exchange expenses	CU 25,000
CR Asset (right to services)	CU 25,000

Non-exchange expenses are recognized as the Local Government Entity satisfies its performance obligation by delivering the services (i.e., providing access to the garden). The value of the expenses is recognized at CU 25,000 per year for 20 years providing the land is continued to be used as a community garden.

Note that this example does not consider the effect of the time value of money and discounting.

Example 8 – Grant to construct a building

Fact Pattern

- A Central Government provides a grant of CU 10,000,000 to a Local Government Entity.
- The grant is to be used to construct an early childhood education facility.
- The construction period is expected to be 12 months.
- The early childhood education facility is required to be used for that purpose for 10 years.
- Any funds not spent on constructing the asset must be returned to the Central Government.
- If the Local Government Entity ceases to use the facility for early childhood education facility within the 10 years, the Central Government can demand repayment of the entire grant.
- The Central Government has enforcement mechanisms to enforce the return of the grant if the use condition is breached.
- The Local Government Entity can legally enforce the payment of the grant by the Central Government.
- A CU 10,000,000 payment is to be made by the Central Government to the Local Government Entity at the beginning of the financial year.
- The Local Government Entity is required to provide the Central Government with a progress report on pre-agreed significant stages of the construction of the facility.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism which requires the Local Government Entity return the funds if it is not spent on constructing the asset. The Local Government Entity can legally enforce the payment of the grant by the Central Government.
- The Central Government can also demand repayment of the grant if it ceases to be used as an early childhood education facility.
- The parents/children using the facility are the beneficiaries.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- There are two requirements in this agreement:
 - The building of the facility
 - There is no transfer of goods or services to the Central Government or a third party beneficiary.
 - **Therefore there is no performance obligation.**
 - The use of the facility.
 - There is a transfer of services to the parents/children that use the facility.
 - **Therefore there is a performance obligation.**

Step 3 – Determine the consideration

- The Central Government expects to transfer CU 10,000,000
- **Therefore the consideration is CU 10,000,000.**

Step 4 – Allocate the consideration

- The full grant is linked to the usage of the asset as an early childhood education facility therefore the consideration should be allocated as grant / number of years
- **Therefore the amount of consideration allocated each year is CU 1,000,000**

Step 5 – Recognize expense

- **Non-exchange expenses are recognized annually at CU 1,000,000 per year**

Accounting treatment

- Non-exchange expenses are recognized when the Local Government Entity satisfies the performance obligation of using the asset as an early childhood education.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of binding arrangement

DR Asset (right to services) CU 10,000,000

CR Liability (grant payable) CU 10,000,000

Entering into a binding arrangement gives rise to a present obligation. In this case, it also gives rise to an asset of equal value, being the right to control the delivery of the agreed services.

Payment of grant

DR Liability (grant payable) CU 10,000,000

CR Bank CU 10,000,000

Subsequent recognition of non-exchange expenses

DR Non-exchange expenses CU 1,000,000

CR Asset (right to services) CU 1,000,000

Non-exchange expenses are recognized at CU 1,000,000 per year for 10 years as the Local Government Entity satisfies its performance obligation by delivering the early childhood education services through the use of the constructed asset.

IPSASB discussion

- **The accounting treatment above assumes that the value of the services delivered to the beneficiaries (and controlled by the Central Government) is approximately equal to the value of the capital grant provided. If this were not the case, should the difference between the value of the services delivered and the value of the grant be accounted for separately (outside the PSPOA)?**
- **If so on what basis should such the value of the services be determined?**

Example 9 – Grant for rental of additional teaching space

Fact Pattern

- A Central Government provides a grant of CU 50,000 to a University. The University can enforce the payment of the grant.
- The grant is to be used to rent extra teaching space due to an increase in student enrolments.
- The university has provided evidence to the Central Government that the required rented teaching space will cost CU 50,000. The rental agreement is initially for one year, but can be renewed by the University
- The grant is renewable annually while the extra teaching space is required.
- The teaching space is to be used to deliver university courses to students.
- The grant is repayable if the teaching space is not used for the full university year on a pro-rata basis.
- The grant is paid at the beginning of the financial year.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism if the university does not use the teaching space for the full university year. The University can enforce the payment of the grant.
- The students using the teaching space are the beneficiaries.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The grant requires the University to use the teaching space to deliver course to students - this is a transfer of a distinct service that is controlled by the Central Government.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The Central Government expects to transfer CU 50,000 to the University to rent teaching space for the delivery of university courses. Because the grant is renewable annually only if the space is still required, the present obligation is only for one year.
- **Therefore the consideration is CU 50,000.**

Step 4 – Allocate the consideration

- The University satisfies its performance obligation by providing teaching services using the rented space. It would therefore be appropriate to allocate the consideration based on rent payable at reporting date.
- **Therefore the consideration is allocated on the basis of rental payable.**

Step 5 – Recognize expense

- **Non-exchange expenses are recognized at the amount of rent payable for the reporting period.**

Accounting treatment

- Non-exchange expenses are recognized as the University satisfies the performance obligation of providing the teaching space for students.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of binding arrangement

DR Asset (right to services) CU 50,000

CR Liability (grant payable) CU 50,000

Entering into a binding arrangement gives rise to a present obligation. In this case, it also gives rise to an asset of equal value, being the right to control the delivery of the agreed services.

Payment of grant

DR Liability (grant payable) CU 50,000

CR Bank CU 50,000

Subsequent recognition of non-exchange expenses

DR Non-exchange expenses CU 50,000

CR Asset (right to services) CU 50,000

Non-exchange expenses are recognized as the University satisfies its performance obligation by delivering the teaching services through the use of the rented space.

If the grant were paid partway through a financial year, non-exchange expenses would be recognized proportionately to the rent payable that related to the financial year.

Example 10 - Payment for the construction of extra teaching space

- A Central Government provides payment of CU 15,000,000 to a University.
- The funds are to be used to construct a building to provide extra teaching space.
- Demographics have determined that there will be an increase in student enrolments for the next 30 years.
- The University is required to use the building as teaching space to deliver courses to students for 30 years.
- The payment of CU 15,000,000 is an interest free loan from the Central Government to the University.
- The payment of CU 15,000,000 is to be made at the beginning of the financial year.
- Each year the building continues to be used for teaching, the Central Government writes down the loan by the value of the depreciation expense incurred. This is treated as a grant, and the University has the right to enforce the right-down of the loan balance where it continues to use the building as teaching space.
- The Central Government has enforcement mechanisms to require pro-rata repayment of the loan if the building ceases to be used as teaching space.
- The building is to be depreciated over the 30 years on a straight-line basis with no residual value.

Application of the PSPOA

Step 1 – Identify the binding agreement

- The Central Government has an enforcement mechanism if the university ceases to use the building as teaching space.
- The University can enforce grant (the right-down of the loan balance) where it continues to use the building as teaching space.
- The students using the teaching space are the beneficiaries.
- **Therefore there is a binding arrangement.**

Step 2 – Identify the performance obligation(s)

- The University is required to use the building as teaching space to deliver course to students - this is a transfer of a distinct service that the Central Government controls.
- **Therefore there is a performance obligation**

Step 3 – Determine the consideration

- The payment of CU 15,000,000 from the Central Government to the University is an interest free loan and not a grant. The concessionary element of the loan is accounted for in accordance with [draft] IPSAS 41, *Financial Instruments*. However, the writing down of the loan by the value of the depreciation incurred is a grant.
- Central Government expects to transfer consideration to the value of CU 15,000,000

Step 4 – Allocate the consideration

- The loan is written down by the value of the depreciation charge each year. Therefore consideration should be allocated on the same basis.
- Therefore the consideration is allocated as CU 500,000 each year.

Step 5 – Recognize expense

- **Non-exchange expenses are recognized as depreciation is incurred, i.e., at CU 500,000 each year**

Accounting treatment

- Non-exchange expenses are recognized as the University satisfies the performance obligation of providing the teaching space for students using the constructed building.
- **This transaction would be accounted for under a PSPOA based standard**

Initial recognition of binding arrangement

DR Asset (right to services)	CU 15,000,000
CR Liability (grant payable)	CU 15,000,000

Entering into a binding arrangement gives rise to a present obligation. In this case, it also gives rise to an asset of equal value, being the right to control the delivery of the agreed services.

Provision of loan

DR Loan Receivable	CU 15,000,000
CR Bank	CU 15,000,000

The initial transfer of the CB 15,000,000 is the granting of a loan. The liability is not extinguished.

Subsequent write down of loan / transfer of grant (annually)

DR Liability (grant payable)	CU 500,000
CR Loan Receivable	CU 500,000

Each year that the building continues to be used for teaching, the government provides a grant by writing down the value of the loan receivable.

Subsequent recognition of non-exchange expenses (annually)

DR Non-exchange expenses	CU 500,000
CR Asset (right to services)	CU 500,000

Non-exchange expenses are recognized each year as the University satisfies its performance obligation by delivering the teaching services through the use of the constructed building.