

Agenda Item 8: Revenue - PSPOA

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Revenue projects context: Categorization of transactions

Current classification	Non-Exchange	Exchange	
CP Revenue	Category A	Category B*	Category C
Characteristics	No performance obligations or stipulations	Enforceable agreements, with performance obligations or stipulations to use or consume resources in a particular way; and/or other agreements requiring resources to be used over a specified period of time	Enforceable agreements, with performance obligations to transfer goods or services to customers on commercial terms
Examples	Taxes, transfers	Funding to deliver a specified number of vaccinations to the public	Sale of goods or services on commercial terms

* Whether Category B transactions are considered to be exchange or non-exchange can differ depending on how the characteristics of the transaction are interpreted.

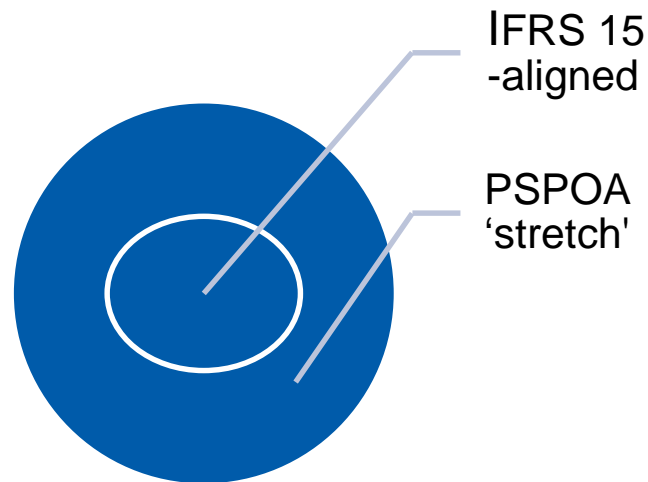
Revenue projects: Way forward

- Board decisions:
 - Replace IPSASs 9 & 11 with IFRS 15-based standard
 - Retain IPSAS 23 – update to address specific application issues
 - Services in kind – maintain current approach
 - Develop Public Sector Performance Obligation Approach (PSPOA) for Category B
 - PSPOA guidance in IFRS 15-based standard
- PSPOA ‘filter mechanism’:
 - Step 1: Binding arrangement?
 - Step 2: Performance obligation? Sufficiently specific?
 - Enforceability key: Revenue of recipient when no enforcement mechanism
- Areas for further discussion:
 - Capital grants
 - ‘Grants, contributions and other transfers’ – guidance / examples location(s)

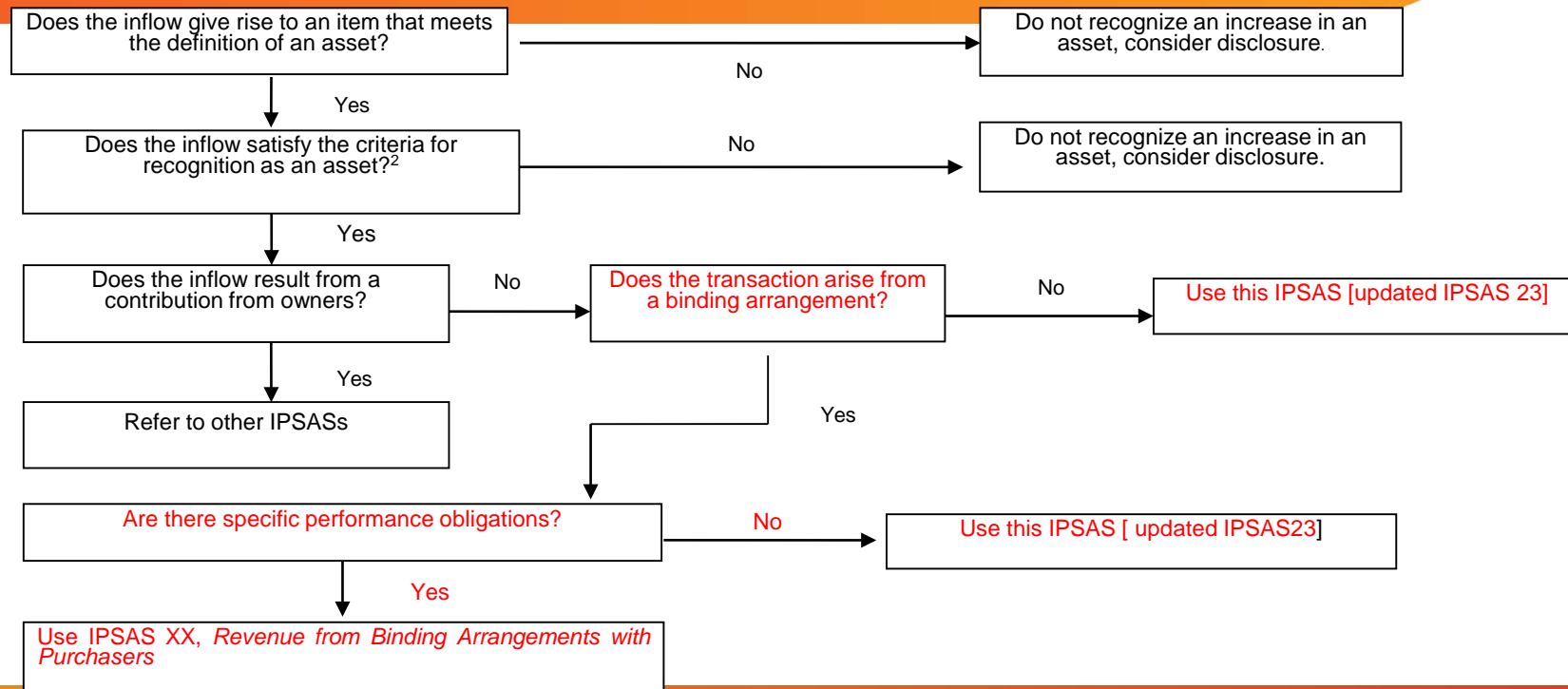
IFRS 15-based IPSAS:

‘Revenue from Binding Arrangements with Purchasers’?

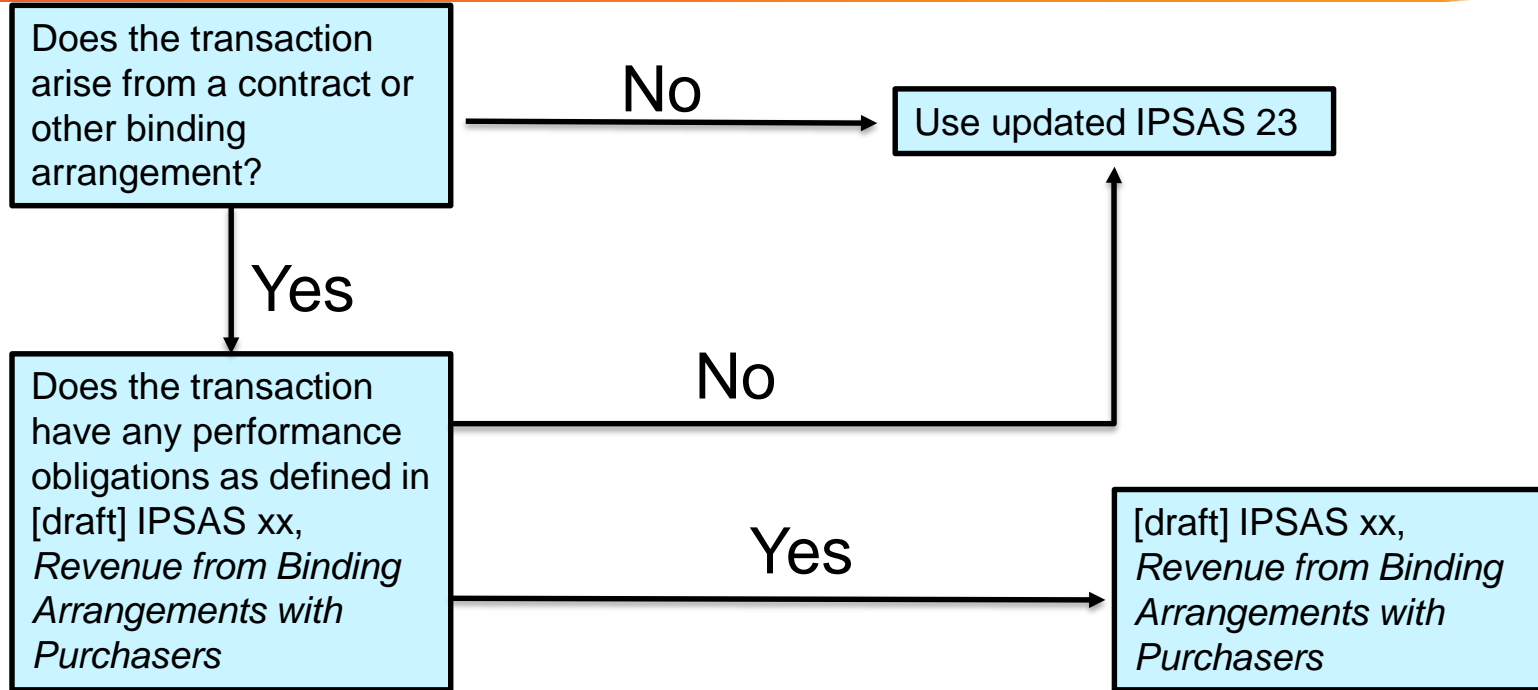
- IFRS 15-aligned core text
- Definitions ‘stretched’ for PSPOA, but clear link to IFRS 15 definitions
- PSPOA Application Guidance (mainly on Steps 1 and 2)
- IFRS 15 examples reviewed for public sector
- Additional PSPOA examples



Updated IPSAS 23: Revised flowchart? - March IPSASB discussion

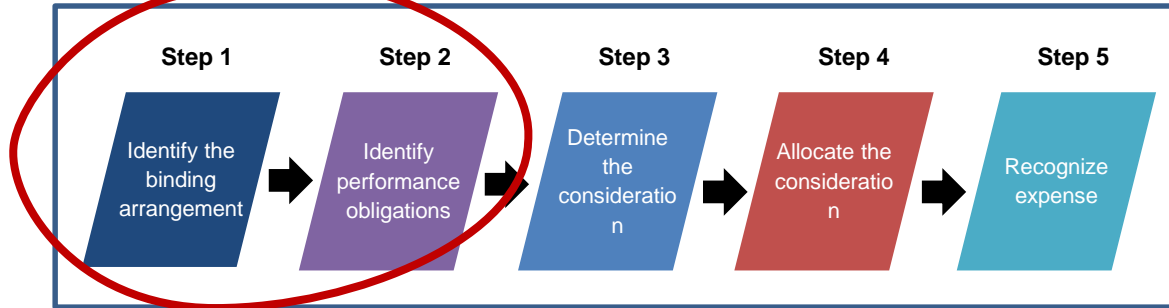


Flowchart – which standard to use?



Grants, Contributions and Transfers - Expense

- PSPOA (including recognition of asset) to be applied to transactions meeting Steps 1 & 2 criteria:



- 'Reverse' IPSAS 23 approach where outside PSPOA
- Key areas under debate in relation to Steps 1 & 2:
 - When should a liability be recognized?
 - Asset recognition? - enforceability?

Objective of Session

To develop Application Guidance and Basis for Conclusion paragraphs for:

- Enforceability – (Step 1) – Agenda Item 8.2.1
- Performance Obligations (Step 2) – Agenda Item 8.2.2

Background

Step 1 of [draft] ED – Identify the Binding Arrangement

- ‘... confers **enforceable** rights and obligations ...’
- enforceability through legal or equivalent means
- IFRS 15 – contract – matter of law
- PSPOA – binding arrangement – equivalent means

CP and other Proposals

Possible 'Equivalent Means' mechanisms

- Legislation and Executive Authority
- Cabinet and Ministerial Decisions
- Reduction of Future Funding
- Sovereign Rights
- Economic Coercion or Political Necessity

Board Decisions – September 2018

Equivalent Means mechanisms to include

- Legislation and Executive Authority
 - Cabinet and Ministerial Decisions
 - (Sovereign Rights)
- Reduction in Future Funding
- ~~Economic Coercion or Political Necessity~~

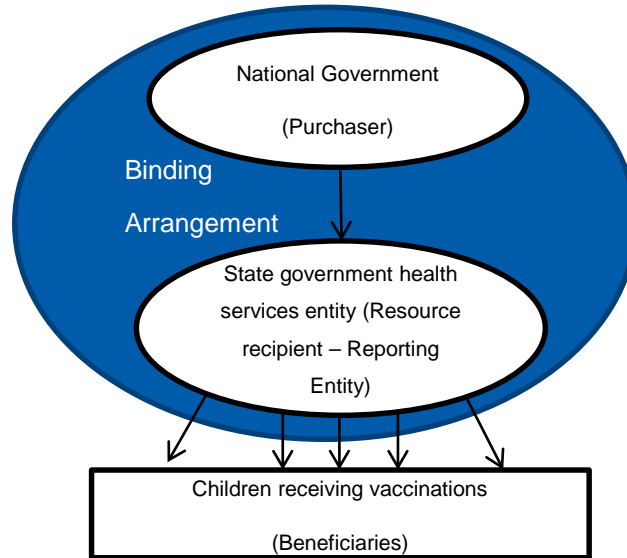
[draft] Application Guidance AG8-AG18

- AG8 One of the key characteristics of a binding arrangement is that the agreement creates enforceable rights and obligations through legal or equivalent means. Paragraph 11 states that factors that determine enforceability may differ between jurisdictions and some enforcement mechanisms may be outside the legal system.
- AG9 Contracts which are a subset of a binding arrangement are enforceable via legal means. However, in the public sector, some entities are not able to contract in their own right but may enter in binding arrangements. To be within the scope of this [draft] IPSAS the rights and obligations in these arrangements must be enforceable by equivalent means.
- AG10 If an arrangement is not enforceable it does not meet the definition of a binding arrangement, and is outside the scope of this [draft] Standard (see updated IPSAS 23).

[draft] Application Guidance AG8-AG18

AG12 Tripartite (three-party) arrangements are common in the public sector – purchaser, resource recipient (reporting entity in this [draft] Standard) and beneficiaries. It is important to recognize that in these tripartite arrangements the beneficiaries do not have any rights to force the entity to deliver goods and services because they are not a party to the binding arrangement. In these tripartite arrangements the resource recipient (reporting entity) is not an agent of the purchaser because the resource recipient gains control of the consideration from the purchaser and is responsible for providing goods or services to the beneficiaries. This relationship is illustrated in the following diagram.

[draft] Application Guidance AG8-AG18



[draft] Application Guidance AG8-AG18

- AG13 Enforcement mechanisms by equivalent means may arise from statutory or administrative arrangements that may create enforceable rights and obligations on the parties to the agreement including:
- (a) Legislation and Executive Authority; and
 - (b) Reduction of future funding.
- AG14 Enforcement mechanisms that are subsets of legislation may include cabinet and ministerial directives and sovereign rights. Cabinet and Ministerial directives may create an enforcement mechanism between different government departments or different levels of government of the same government structure. For example a directive given by a Minister or government department to an entity controlled by the government to transfer goods or services may be enforceable.

[draft] Application Guidance AG8-AG18

- AG15 Sovereign rights (the ability to make amend and repeal legal provisions) on their own are not a valid enforcement mechanism – that is the power and existence of such rights. However if the use of sovereign rights were detailed in the binding arrangement as a means of enforcement this may result in a legislative enforcement mechanism.
- AG16 In general the ability to reduce future funding to which the entity is not presently entitled would not be considered a valid enforcement mechanism in the context of this [draft] Standard because there is no present obligation on the purchaser to provide such funding. However, the entity was presently entitled to funding in the future (through another binding arrangement) then this could be considered a valid enforcement mechanism.

[draft] Application Guidance AG8-AG18

- AG17 When determining if a reduction of future funding would be an enforcement mechanism the entity must make a judgement based on the facts and circumstances. For example the purchaser's ability to reduce future funding, their past history of doing so, or the likelihood that they would do so in reference to the binding arrangement. Although past history of enforcement of similar agreements is a good indicator that a purchaser may enforce an arrangement by the threat of a reduction of future funding, non-enforcement of similar agreements does not affect the enforceability of future agreements, the key factor is that the purchaser has the ability to enforce its rights.
- AG18 A statement of intent or public announcement for a purchaser (e.g. government) to spend money or deliver goods and services in a certain way is not an enforceable arrangement for the purposes of this [draft] Standard. Such a declaration is general in nature and does not create a binding arrangement between a purchaser and an entity (resource recipient). An entity would need to consider whether such a public announcement gives rise to a non-legally binding (constructive obligation) under IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

[draft] Basis for Conclusions BC13-BC20

- BC13 The Board noted that some binding arrangements are enforceable not by legal means but by equivalent enforcement mechanisms and discussed which of these mechanisms would be appropriate to use in this [draft] Standard.
- BC14 The Consultation Paper, Accounting for Revenue and Non-Exchange Expenses, proposed
- (a) Legislation;
 - (b) Cabinet and ministerial decisions; and
 - (c) Reduction of future funding
- as possible enforcement mechanisms by equivalent means. Respondents to the CP were generally supportive but were unsure about the validity of a reduction of future funding as an enforcement mechanism.

[draft] Basis for Conclusions BC13-BC20

- BC15 The Board also discussed sovereign rights and economic coercion or political necessity.
- BC16 The Board agreed that cabinet and ministerial decisions and sovereign rights were subsets of legislation and may in some circumstances be valid enforcement mechanisms. They discussed sovereign rights and agreed that by themselves, sovereign rights do not establish a valid enforcement mechanism. However, if details on how sovereign rights would be used to enforce an agreement were include in the binding arrangement then this may create a valid enforcement mechanism.
- BC17 The Board also discussed whether the threat of reduction of future funding created a valid enforcement mechanism and decided that it could only be used to enforce a binding arrangement if purchaser had a present obligation to provide future funding in a separate binding arrangement. Without this separate binding arrangement and present obligation there is not future funding to be reduced.

[draft] Basis for Conclusions BC13-BC20

- BC18 The Board also discussed whether economic coercion or political necessity could be a valid enforcement mechanism. The noted that paragraph 5.26 of the *Framework* states “economic coercion, political necessity or other circumstances may give rise to situations where although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political; necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.
- BC19 However, the Board were of the view that a liability arising from a non-legally binding obligation is not equivalent to a binding arrangement for the purposes of this [draft] IPSAS because a non-legally giving obligation as cited in the *Framework* is binding on the promisor only whereas a binding arrangement as used in this IPSAS both parties have to agree to the rights and obligations within that agreement.

[draft] Basis for Conclusions BC13-BC20

- BC20 The Board also discussed whether a statement made by a government to spend money or use assets in a particular way (e.g. a general policy statement or announcement following a natural disaster) would create an enforceable binding arrangement. The Board decided that such an announcement does not create enforceable rights and obligations on parties as there is no agreement between the parties, and therefore there is no binding arrangement. Such an announcement may be accounted for under IPSAS 19.

Questions for the Board

Does the IPSASB agree with:

- The Application Guidance paragraphs on Enforceability
- The placement of this Application Guidance
- The Basis for Conclusions paragraphs
- The placement of the Basis for Conclusions Paragraphs

Background

- Key principle – revenue is recognized when (or as) a performance obligation is fulfilled.
 - Distinct goods and services
 - Transfer of these goods and services
- Previously discussed at the June 2018 meeting

Distinct goods and services

- Purchaser can benefit from the good or service on its own or with readily available resources.
- The promise the transfer good or service is separately identifiable from other promises in the binding arrangement.
- AASB additional criterion – sufficiently specific
- Board had mixed views re extra criterion

Transfer

- Problematic as not all transactions result in a transfer
 - Capital grants and some research grants
- Board decided to retain transfer
 - Non-exchange expenses reliant on transfer

Application Guidance – AG29-AG44

- AG29 This [draft] IPSAS requires revenue to be recognized when a performance obligation is fulfilled, therefore a performance obligation is a unit of account for recognition and a key element to applying this [draft] Standard.
- AG30 Paragraphs 23 requires an entity to identify any performance obligations when a binding arrangement is entered into (Step 2 of the revenue recognition model). A performance obligation is defined as a promise [by the entity] in a binding arrangement with a purchaser to transfer to the purchaser 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 purchaser.
- AG31 The key features of this definition is that goods and services must be distinct and there must be a transfer of these goods and services. If goods or services (or a bundle of goods or services) are not transferred and/or are not distinct the transaction is outside the scope of this Standard (refer to [updated] IPSAS 23).

Application Guidance – AG29-AG44

Distinct goods and services

- AG32 A good or service promised in a binding arrangement is distinct if the following two criteria are both met (paragraph 28):
- (a) The purchaser can benefit or receive service potential from the good or service either on its own or together with other resources that are readily available to the purchaser (i.e. the good or service is capable of being distinct). A purchaser can benefit or receive service potential from the good or service transferred to a beneficiary where the transfer of the good or service to the beneficiary contributes to the purchaser achieving its service objectives; and
 - (b) The entity's promise to transfer the good or service to the purchaser is separately identifiable from other promises in the binding arrangement (i.e. the promise to transfer the good or service is distinct within the context of the binding arrangement).

Application Guidance – AG29-AG44

- AG33 That is, not only the goods and services in a promise must be distinct but also the promises within a binding arrangement must be distinct (separately identifiable) from other promises within the same binding arrangement. Therefore, it is possible to have several performance obligations within one binding arrangement.
- AG34 To illustrate, a binding arrangement between Entity A and Entity B may have several promises, each of them distinct and separately identifiable from the others but within those promises the goods and services may or may not be distinct. Goods and services that are not distinct within a promise are bundled together until that bundle is distinct. The diagram below illustrates how one binding arrangement could have three separately identifiable promises to deliver goods and services.

Application Guidance – AG29-AG44

Binding Arrangement between Entity A and Entity B – Entity A provides 120,000CU funding for Entity B to:

Promise 1

- Build 4 wells in Village X to provide clean drinking water for the villagers to use - 10,000CU per well

Promise 2

- Develop software to allow the village administrators to monitor the quality of water of the drinking wells - 75,000CU

Promise 3

- Provide vaccinations to the 1,000 children of Village X - 5CU per vaccine

Application Guidance – AG29-AG44

- AG35 The first promise in this binding arrangement is that Entity B will build four wells to provide drinking water at Village X. To build each well a number of goods and services will be required (labor, building materials, design etc.) each of which are capable of being distinct in their own right. However, the promise from Entity B to Entity A is to deliver fully functioning wells, therefore each of these individual goods and services must be bundled to create a single performance obligation.
- AG36 Further because each well can be used independently of the other this promise has four performance obligations and revenue would be recognized as each well is completed.
- AG37 The second promise is for Entity B to develop software to monitor the drinking well's water quality. Again this may involve the bundling of goods and services such as labor and technical knowhow. Revenue would be recognized when this software was completed, tested and functioning

Application Guidance – AG29-AG44

- AG38 Finally the third promise in this binding arrangement it to vaccinate 1000 children of Village X. This promise represents a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the purchaser (paragraph 23(b)). Therefore, this promise, although it could be argued to be 1,000 separate performance obligations, is treated as one performance obligation and revenue is recognized over time. Further guidance on performance obligations satisfied over time can be found at paragraphs AG45 – AG56.
- AG39 To contrast if Entity A entered into an agreement to Entity B to provide funding for the general operations of the Administrative office for Village X, there are no distinct goods or services promised within the agreement and therefore this transaction is outside the scope of this [draft] Standard.

Application Guidance – AG29-AG44

Transfer of Goods and Services

- AG40 The second requirement of a performance obligation is that there must be a transfer of goods and services to the purchaser or, in the public sector, a beneficiary. If there is no transfer of good or services the transaction is outside the scope of this Standard (refer to [updated] IPSAS 23).
- AG41 This [draft] IPSAS requires that revenue is recognized when an entity satisfies a performance obligation by transferring a promised good or service to a purchaser. The transfer of the good or service is indicated when the purchaser gains control of the promised goods or services.
- AG42 Paragraph 34 provides indicators of control which include:
- (a) The ability to direct the use of obtain substantially of the remaining benefits or service potential of the asset; and
 - (b) The ability to prevent others from directing or using the benefits or service potential of the asset.

Application Guidance – AG29-AG44

- AG43 Each of the examples above in paragraphs AG35 – AG38 result in a transfer of goods and services from Entity B to the beneficiaries (the villagers).
- AG44 An example of an arrangement that would not satisfy this requirement to transfer goods or services may be if Entity A (purchaser) provides funding to Entity B to undertake a particular research program but there is no requirement for Entity B to provide any intellectual property generated from the research to either Entity A or a beneficiary.

Basis for Conclusions – BC26-BC27

- BC26 The Board discussed whether it was necessary to add a further criterion to complement ‘distinct’ in a promise in a binding arrangement to enable the promises within a binding arrangement to be identified, so that an entity could determine when a performance obligation was fulfilled. The Board considered terms such as ‘sufficiently specific’. However, the Board decided that the requirements in the [draft] IPSAS were appropriate for the identification of separately identifiable promises.
- BC27 The Board discussed whether the requirement in IFRS 15 that a performance obligation include the transfer of goods and services to be within scope should be modified to include some transactions that do not result in a transfer of a good or service (e.g. capital grants and some research grants). The Board decided to maintain the IFRS 15 requirements for a performance obligation. Transactions that did not have performance obligations would be addressed in an updated IPSAS 23.

Questions for the Board

Does the IPSASB agree with:

- The Application Guidance paragraphs on *Identifying a Performance Obligation in a Binding Arrangement*
- The placement of this Application Guidance
- The Basis for Conclusions paragraphs
- The placement of the Basis for Conclusions Paragraphs



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