

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Washington D.C., USA

Meeting Date: March 12–15, 2019

From: Joanna Spencer

Agenda Item 8

For:

☐ Approval

☒ Discussion

☒ Information

REVENUE – ENFORCEABILITY AND BINDING ARRANGEMENTS

Project summary	Revenue <p>The aim of the project is to develop one or more IPSAS covering revenue transactions (exchange and non-exchange) in IPSAS.</p> <p>The scope of this project is to develop new standards-level requirements and guidance on revenue to amend or supersede that currently located in IPSAS 9, <i>Revenue from Exchange Transactions</i>, IPSAS 11, <i>Construction Contracts</i> and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i>.</p>	
Meeting Objectives	Topic	Agenda Item
Project management	Decisions up to December 2018 Meeting	8.1.1
	Instructions up to December 2018 Meeting	8.1.2
	Revenue Project Roadmap	8.1.3
Discussion Items	Revenue - Enforceability	8.2.1
	Revenue – Performance Obligations	8.2.2

Agenda Item

8.1.1

DECISIONS UP TO DECEMBER 2018 MEETING

Date of Decision	Decision
December 2018	The Board decided to approve the scope of the draft Standard.
December 2018	The Board decided to replace the term, "Customer" with the broader term, "Purchaser".
December 2018	The Board decided to complement the definition of a binding arrangement by specifying criteria that must be met before an entity can apply the revenue recognition model to that binding arrangement.
December 2018	The Board decided to retain the criteria used in IFRS 15 for revenue transactions, which would be within the scope of IFRS 15.
December 2018	The Board decided that enforceability is key in determining under which IPSAS a transaction will be addressed.
December 2018	The Board decided that revenue from transactions that are not enforceable but which have intentions/expectations on how the resources are to be used is to be recognized when receivable and the entity is to communicate these intentions/expectations via enhanced display and or disclosure.
September 2018	The Board decided to accept the proposed "Amendments to Other IPSAS".
September 2018	The Board decided that legislation and the ability to reduce future funding should be included as potential enforcement mechanisms for the PSPOA.
September 2018	The Board decided to replace "commercial substance" with "economic substance".
September 2018	The Board decided to remove the term, "ordinary" and explore the scope to identify whether items such as gains on sale of property, plant and equipment, foreign exchange gains, and interest are within the scope of the draft Standard.
September 2018	The Board decided to retain the methods used to estimate stand-alone selling price and add explanatory text, stating that, where appropriate, the Expected Cost plus Margin approach is also applicable to goods and services that are provided on a cost-recovery basis.
September 2018	The Board decided to retain the terms, "Goods and Services".
September 2018	The Board decided to retain the terms, "Consideration" and "Exchange".
September 2018	The Board decided to replace the terms, "Contract Asset" and "Contract Liability" with the terms "Binding Arrangement Asset" and "Binding Arrangement Liability".
September 2018	The Board decided to use the term, "Binding Arrangement", which will encompass the terms, "Contract" and "Other Binding Arrangements".
June 2018	The Board decided that the requirements for accounting for revenue from social contributions should adopt the same principles as for taxation revenue.
June 2018	The Board decided that, in dealing with Category C revenue transactions, there are no major public sector issues that warrant departure, after considering the alignment with IFRS 15, <i>Revenue from Contracts with Customers</i> .
June 2018	The Board decided to retain the term "Fair Value" until the project on Public Sector Measurement is concluded.

Revenue (Decisions up to December 2018 meeting)
IPSASB Meeting (March 2019)

Date of Decision	Decision
June 2018	The Board decided to approve the terminology changes, and, with some clarifications, the definitions.
June 2018	The Board decided to proceed with the PSPOA for appropriate transactions that were classified as Category B in the Consultation Paper, <i>Accounting for Revenue and Non-Exchange Expenses</i> .
June 2018	The Board decided not to change the existing recognition requirements for recognizing services in-kind in IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i> .
March 2018	The Board decided that IPSAS 23 should be updated.
March 2018	The Board decided to progress with a convergence project on IFRS 15, <i>Revenue from Contracts with Customers</i> .
June 2017	All decisions made up until June 2017 or earlier were reflected in the Consultation Paper, Accounting for Revenue and Non-Exchange Expenses .

Agenda Item

8.1.2

INSTRUCTIONS UP TO DECEMBER 2018 MEETING

Meeting	Instruction	Actioned
December 2018	The Board instructed staff to add a specific exclusion for the amount of consideration included in the surplus or deficit arising from the disposal of investment property dealt with in accordance with IPSAS 16, <i>Investment Property</i> , property, plant and equipment dealt with in accordance with IPSAS 17, <i>Property, Plant and Equipment</i> and intangible assets dealt with in accordance with IPSAS 31, <i>Intangible Assets</i> .	Agenda Item 9.2.1 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to replace the example of oil and milk used for non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. (The IPSASB instructed staff to consider using an example that is more suitable for the Public sector).	Agenda Item 9.2.1 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to provide a definition of the term, "Purchaser", which incorporates the term, "Customer" as defined in IFRS 15.	Agenda Item 9.2.2 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to include explanatory text in the Basis for Conclusions of other terms that were considered to replace the term, "Customer".	Agenda Item 9.2.2 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to consider the definition of binding arrangements in the draft Standard.	Agenda Item 9.2.2 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to provide explanatory text in the Application Guidance or Basis for Conclusions for certain criteria that are difficult to meet in the public sector. (For instance, private sector entities generally enter into contracts for which collection of payment is probable. This may not always be the case in the public sector, as entities may enter into contracts in which collection of payment is not probable; for example, where an entity is legally required to supply electricity to customers with high credit risk).	Agenda Item 9.2.3 and Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.

Meeting	Instruction	Actioned
December 2018	The Board instructed staff to consider whether the title for the draft Standard should be ' <i>Revenue from Binding Arrangements</i> ' bearing in mind the need to fit with / complement the other elements of the Revenue and Non-Exchange Expenses workstreams.	To be addressed in June 2019.
December 2018	The Board instructed staff to relocate text in boxes in the draft ED included in the Board papers to Application Guidance (for the Public Sector Performance Obligation Approach) or Basis for Conclusions and to consider the overall flow of the text.	Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to provide a complete version of the main ED text for preliminary approval at the March 2019 meeting in order to provide the 'cornerstone' for development of the EDs on Grants and Transfers, and the updated IPSAS 23.	Agenda Item 9.3: [draft] Exposure Draft ED(XX), Revenue from Binding Arrangements with Purchasers.
December 2018	The Board instructed staff to develop drafting on how enhanced display and or disclosure could be communicate the intention/expectations for the use of resources.	To be addressed in June 2019
December 2018	The Board instructed staff to develop guidance on when an entity has control of a resource including discussions on: <ul style="list-style-type: none"> • Appropriations • Budgets • Multi-year funding 	To be addressed in June 2019
December 2018	The Board instructed staff to assess whether an IPSAS 23 'condition' is equivalent to an IFRS 15 'performance obligation'.	To be addressed in June 2019
September 2018	The Board instructed staff to provide options for the title of the draft Standard and show the benefits and disadvantages of these options.	To be addressed in June 2019.
September 2018	The Board instructed staff to consider the scope of the draft Standard and identify whether items such as Dividend Income, Gains on Sale of Property, Plant and Equipment (PPE), Foreign Currency Gains and Interest Income are within the scope.	
September 2018	The Board instructed staff to define the term, "Binding Arrangement", in the main text of the draft Standard and include explanatory text for the terms, "Contract" and "Other Binding Arrangements", in the Basis of Conclusions or Application Guidance.	
September 2018	The Board instructed staff to select either the umbrella term that encompasses the term, "Customer", or the use of the term "Customer" as the umbrella term and provide explanatory text in the Application Guidance or Basis of Conclusion.	

Meeting	Instruction	Actioned
September 2018	The Board instructed staff to add explanatory text in the Application Guidance or Basis of Conclusions that the “Expected Cost plus Margin Approach” is also applicable to goods and services that are provided on a cost-recovery basis.	
September 2018	The Board instructed staff to ensure consistency with other IPSAS and determine whether consequential amendments are necessary for the change of “commercial substance” to “economic substance”.	To be discussed at a future meeting.
September 2018	The Board instructed staff to develop guidance on enforceability acknowledging that enforcement mechanisms may be jurisdictionally specific. Further, the guidance should demonstrate how these mechanisms would work.	Agenda Item 8.2.1
September 2018	The Board instructed staff to consider the New Zealand requirements for providing qualitative disclosures for entities that are reliant on services in-kind for their operations.	To be discussed at a future meeting.
September 2018	The Board instructed staff to redraft the section to explain the principles, using a generic term; which will avoid multiple references to “taxes and other compulsory contributions and levies” and prevent confusion over whether transactions are taxes or levies.	To be discussed at a future meeting.
September 2018	The Board instructed staff to consider the Government Finance Statistics definitions of taxation and levies.	To be discussed at a future meeting.
September 2018	The Board instructed staff to consider including Application Guidance that sets out which transactions are covered, noting the link to social contributions.	To be discussed at a future meeting..
June 2018	The Board instructed staff to check the consistency of the use of the terms “Binding Arrangement or Other Binding Arrangements”.	
June 2018	The Board instructed staff to check whether the difference in the definitions to the term “Binding Arrangements,” as per IPSAS 32, <i>Service Concession Arrangement</i> and IPSAS 35, <i>Joint Arrangements</i> , is due to timing rather than due to substance, since IPSAS 32 was issued before publication of the Conceptual Framework, while IPSAS 35 was published after the Conceptual Framework.	
June 2018	The Board instructed staff to consider adding the terms, “Binding Arrangement Asset” and “Binding Arrangement Liability” to “Contract Asset” and “Contract Liability,” respectively since governments may enter into contracts and/or binding arrangements.	

Meeting	Instruction	Actioned
June 2018	The Board instructed staff to consider whether the definition of “Contract Asset” suits the context of the public sector since the definition of Contract Asset is the entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer.	
June 2018	The Board instructed staff to reconsider changing the term, “Customer” to suit the context of the public sector.	
June 2018	The Board instructed staff to consider swapping the order of “goods and services” to “services and goods.”	
June 2018	The Board instructed staff to move the positioning of the definitions from the Appendices to the body of the standard.	
June 2018	The Board instructed staff to explore whether a reduction in future funding and government powers would be appropriate enforcement mechanisms.	
June 2018	The Board instructed staff to develop guidance to articulate the principle that the customer is the entity that directs and enforces delivery of goods and services.	
June 2018	The Board instructed staff to consider replacing the term ‘commercial substance’ with ‘economic substance’.	
June 2018	The Board instructed staff to develop guidance to articulate what ‘distinct’ would mean when identifying goods and services to be transferred in a performance obligation.	Agenda Item, 8.2.2
June 2018	The Board instructed staff to provide options on how wording and placement of encouragements to recognize or disclose services in-kind would appear in an updated IPSAS 23.	To be discussed further a a future meeting.
June 2018	The Board instructed staff to simplify the draft guidance provided by referring to tax and other compulsory levies.	
March 2018	The Board directed staff to reexamine respondent comments to the CP regarding services in-kind and to shape the arguments for each option.	
March 2018	The Board directed to conduct desk research on service in-kind to determine the requirements of other standard setters and also to investigate how not-for-profit entities (not restricted to the public sector) account for services in-kind.	

Revenue (Instructions up to December 2018 meeting)
IPSASB Meeting (March 2019)

Meeting	Instruction	Actioned
March 2018	The Board directed staff to further develop the Public Sector Performance Obligation Approach model complete with examples to test the model.	
December 2017	As part of the review of the Work Plan, the IPSASB instructed staff to consider revenue as three separate streams, <i>IFRS 15 Convergence, Updated IPSAS 23 and Grants and other Transfers</i> .	
December 2017	The IPSASB requested staff consider how the Specific Matters for Comment and Preliminary Views relate to the different revenue and non-exchange expenses project streams.	
June 2017	All instructions provided up until June 2017 or earlier were reflected in the Consultation Paper, Accounting for Revenue and Non-Exchange Expenses .	

Agenda Item

8.1.3

REVENUE PROJECT ROADMAP

Meeting	Objective: IPSASB to consider:		
	Revenue from Contracts with Customers (IFRS 15 Convergence & PSPOA for Revenue)	Limited Update of IPSAS 23	Grants and other Transfers
March 2019	1. Discuss Issues 2. Develop ED	1. Discuss Issues 2. Exposure Draft	1. Discuss Issues 2. Exposure Draft
June 2019	1. Exposure Draft	1. Exposure Draft	1. Exposure Draft
September 2019	1. Approve ED	1. Approve ED	1. Approve ED
December 2019			
March 2020			
June 2020	1. Review Responses	1. Review Responses	1. Review Responses
September 2020	1. Discuss Issues	1. Discuss Issues	1. Discuss Issues
December 2020	1. Discuss Issues 2. Develop IPSAS	1. Discuss Issues 2. Develop IPSAS	1. Discuss Issues 2. Develop IPSAS
H1 2021	1. Approve IPSAS	1. Approve IPSAS	1. Approve IPSAS

Revenue - Enforceability

Questions

1. The Board is asked to consider the draft Application Guidance and Basis for Conclusions for *Enforceability* to be included in the [draft] Exposure Draft (ED), *Revenue from Binding Arrangements with Purchasers* (Agenda Item 9.3) and placement of that drafting.

Detail

2. The purpose of this session is to review draft Application Guidance and Basis for Conclusions on enforceability mechanisms for use in the Public Sector Performance Obligation Approach (PSPOA).
3. Step 1 of the five-step approach for applying the performance obligation based revenue recognition model in the [draft] ED is *Identifying the Binding Arrangement*. A binding arrangement is defined as 'an arrangement that confers enforceable rights and obligations on the parties to the arrangement. A binding arrangement includes contracts. Therefore a key element of a binding arrangement is that it is enforceable.
4. Paragraph 11 of the [draft] ED states 'Enforceability of the rights and obligations in a binding arrangement is created through legal or equivalent means'. Enforcement beyond 'legal mean' has been extended from the in IFRS 15, *Revenue from Contracts with Customers* (the Standard upon which the [draft] ED is based). IFRS 15 paragraph 10 states 'Enforceability of the rights and obligations of a contract is a matter of law' implying by legal means only. However, IFRS 15 is restricted to legal contractual arrangements whereas the [draft] ED has been expanded to binding arrangements (which includes contracts) because some jurisdictions do not allow public sector entities to enter into contracts. Therefore it is necessary for the [draft] ED to allow enforcement mechanisms beyond just legal, that is by equivalent means.
5. The Consultation Paper, *Accounting for Revenue and Non-Exchange Expenses* suggested the following non-contractual enforcement mechanisms should be considered:
 - (a) Legislation;
 - (b) Cabinet and ministerial decisions; and
 - (c) Reduction of future funding.

Respondents to the CP were generally supporting of these enforcement mechanisms but the validity of reduction of future funding was queried.
6. The Board discussed enforceability mechanisms at the June 2018 and September 2018 meetings. Staff put forward the following enforcement mechanisms at the September 2018 meeting for consideration:
 - (a) Legislation and Executive Authority;
 - (b) Cabinet and Ministerial Directives;
 - (c) Sovereign Rights;
 - (d) Ability to reduce future funding; and

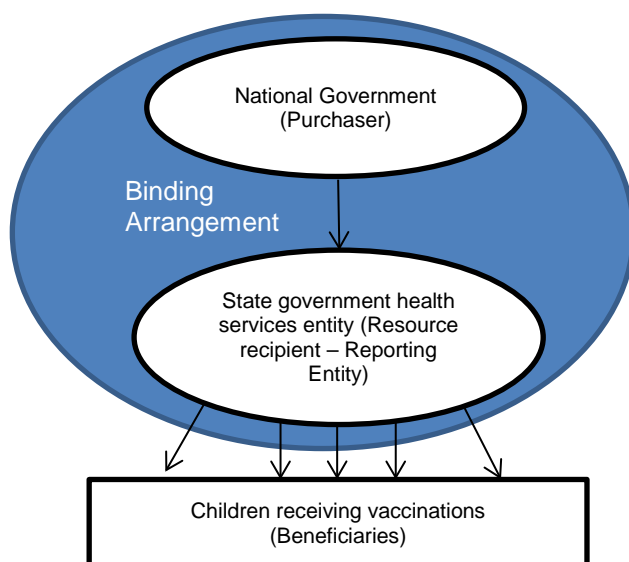
- (e) Economic coercion or political necessity.
7. The Board agreed that Legislation and Executive Authority could be valid enforcement mechanisms for use in the PSPOA. The decision to include Executive Authority was not as definitive as that for Legislation but members commented that in some circumstances it can be used to enforce and agreement therefore it should be included in the [draft] ED.
 8. Regarding Cabinet and Ministerial Directives it was decided that these types of enforcement mechanisms are a subset of Legislation.
 9. The Board agreed that Sovereign Rights on their own that is just the existence and power is not enough to create a valid enforcement mechanism. If the use of sovereign rights were included in a binding arrangement as an enforcement mechanism, the Board considered that this would be equivalent to being included in Legislation.
 10. The Board discussed reduction on future funding at both the June 2018 and September 2018 meetings and agreed that in some circumstances it could be a valid enforcement mechanism. These circumstances included that there had to be an existing agreement for future funding between the two entities, and a preparer needed to look at the facts and circumstances – that is the ability to reduce any future funding and their past history of doing so or the likelihood that they will do so.
 11. The Board decided that economic coercion or political necessity were not valid enforcement mechanisms.
 12. To summarize the [draft] ED will include Legislation and Executive Authority, and Reduction of Future Funding as possible enforcement mechanisms, with Cabinet and Ministerial Directives, and Sovereign Rights as a subset of Legislation.
 13. The Board also agreed that the drafting should articulate that in a tripartite agreement enforceability is between the two parties to the binding arrangement (purchaser and resource recipient) and not the beneficiary.
 14. Further the Board agreed that the Basis for Conclusions should discuss the difference between an IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* obligation and enforceability and enforceability under the PSPOA.
 15. Staff have provided draft Application Guidance and Basis for Conclusions for the Board's consideration. This drafting is provided as Appendix A and Appendix B to this paper and are included in the [draft] ED (Agenda Item 9.3) at paragraphs AG8-AG18 and BC13-BC20.

Decision(s) required

16. The IPSASB is asked whether it agrees with:
 - (a) The Application Guidance on *Enforceability*;
 - (b) The placement of this Application Guidance at paragraphs AG8-18 of the [draft] ED;
 - (c) The Basis for Conclusions paragraphs; and
 - (d) The placement of the Basis for Conclusion paragraphs at BC13-BC20 of the [draft] ED.

Enforceability – Application Guidance

- 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).
- AG11 Enforceability mechanisms by equivalent means may take many forms and maybe jurisdictionally specific. But a key factor is that either the purchaser or a separate entity must be able to enforce the binding arrangement. The purchaser or a separate entity must have the ability and authority to compel the entity to fulfil the promises established within the agreement or to seek redress should those promises not be fulfilled.
- 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.



- 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.
- 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.
- 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*.

Enforceability of a Binding Arrangement – Basis for Conclusions

- 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.
- 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 included 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.
- 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.
- 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.

Revenue – Performance Obligations

Questions

1. The Board is asked to consider the draft of Application Guidance and Basis for Conclusions for *Identifying a Performance Obligation in a Binding Arrangement* to be included in the [draft] Exposure Draft (ED), *Revenue from Binding Arrangements with Purchasers* (Agenda Item 9.3) and placement of that drafting.

Detail

2. The purpose of this session is to review draft application guidance on how to identify whether a performance obligation exists, for use in [draft] ED.
3. The key principle of this [draft] ED is that revenue is recognized when a performance obligation has been fulfilled. The concept of a performance obligation has been discussed at the June 2018 and September 2018 IPSASB meetings and following is a brief review of the issues and discussion to date.
4. A performance obligation in [draft] ED is defined (at paragraph 9 of the [draft] ED) as follows:
[A] Performance obligation is a promise 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.
5. At the June 2018 IPSASB the Board discussed two aspects of this definition that may need to be addressed for use in the Public Sector Performance Obligation Approach (PSPOA). These two aspects were:
 - (a) The requirement that a good or service was distinct; and
 - (b) That the goods or services must be transferred to the purchaser.

Distinct goods and services

6. Paragraph 28 of the [draft] ED states that a good or service that is promised to a purchaser is distinct if both the following criteria are met:
 - (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).

7. In analyzing these criteria it is evident that it is not only the goods and services that must be distinct but a promise must also be distinct from other promises within the same binding arrangement.
8. To clarify, a single binding arrangement may contain several promises, each of these promises must be distinct and separately identifiable from the others within that binding arrangement. Further within those promises the goods and services may or may not be distinct. If goods and services are distinct they are each accounted for as separate performance obligations.
9. However if the goods and services are not distinct the entity combines those goods and services with other promised goods and services until it identifies a bundle of good or services that is distinct. For example, the promised good may be specialized machine to fulfil a certain function, which requires fabricating. All the materials necessary to build this machine are capable of being distinct, however the promise in the binding arrangement was to transfer a specialized machine, and not the components that create this machine, therefore these goods and services are bundled and accounted for as one performance obligation.
10. A first key feature of a distinct good or service is that an entity can benefit from that good or service on its own or with other readily available resources (paragraph 28(a) of the [draft] ED). Paragraph 29 provides detail about how to determine if an entity can benefit from a good or service.
11. The second requirement for a good or service to be distinct is that the promise to transfer that good or service is separately identifiable from other promises within the binding arrangement (paragraph 28(b) of the [draft] ED). Paragraph 30 of the [draft] ED also provides detail on determining separately identifiable promises within a binding arrangement.
12. Staff consider that these paragraphs are very comprehensive and consider that only minimal application guidance is necessary on this particular aspect of 'distinct' goods and services and 'distinct' promises.
13. At the June 2018 meeting the Board noted that the Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses* stated that identifying distinct goods and services in the public sector can be challenging because:
 - (a) The specificity of services may be implied rather than explicitly stated; and/or
 - (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.
14. The CP also 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'.
15. The Board also noted the Australian Accounting Standard's Board (AASB) Not-for Profit Specific Application Guidance to AASB 15 *Revenue from Contracts with Customers* includes a requirement that "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."
16. The reasoning for this additional requirement was that often within the not-for-profit sector entities are provided with no or minimal terms and conditions regarding how those assets are to be used other than the assets are used for purposes consistent with the entity's service-delivery objectives. Some other assets may be provided solely on the condition that they are to be used over a certain time period. Because there may be a lack of clarity around the purpose for these transfers the AASB

decided that a promise within a contract must be sufficiently specific to qualify as a performance obligation.

17. The Board discussed whether the term 'sufficiently specific' should be included in the guidance for the PSPOA and there were mixed views as to its inclusion as such staff have not included this requirement (or something similar) into the draft application guidance but rather have emphasized the [draft] ED requirement that the promise as well as the goods and services within that promise have to be distinct (see above).
18. As a result of the discussion the Board asked staff to develop guidance to articulate what 'distinct' would mean when identifying performance obligations.

Transfer

19. The second aspect of a performance obligation that the Board discussed at the June 2018 meeting was the requirement that the goods and services had to be transferred to the purchaser. It was noted that for some public sector transactions this requirement may be problematic because there is no transfer back to the purchaser or to a third party beneficiary. These transactions may include capital and research grants. The Board discussed whether the definition of a performance obligation should be extended beyond a transfer of goods or services to the purchaser or beneficiary but decided to retain this feature as an essential element of a performance obligation.
20. This decision was reconfirmed when the Board decided that the PSPOA should be used for non-exchange expenses. Under the proposed accounting for non-exchange expenses an entity (grantor/resource provider) will recognize an asset, (the resource being the right for goods and services to be transferred) and then as these goods and services are transferred the entity will derecognize the asset and recognize and expense. If there no requirement to transfer there would be no asset and the PSPOA could only be applied to non-exchange expenses by recognizing an 'other resource'. Therefore the requirement to transfer remains key for accounting for non-exchange expenses.

Staff Recommendations

21. Staff recommend that because the requirements of a performance obligation in the [draft] ED remain the same as in IFRS 15, *Revenue from Contracts with Customers* (the basis of the [draft] ED – that is these requirements have not been extended, that extensive application guidance is not necessary.
22. As such staff have drafted minimal application guidance on *Identifying a Performance Obligation in a Binding Arrangement*, and this drafting is provided in the [draft] ED (Agenda Paper 9.3) at paragraphs AG29 – AG44 and is also reproduced in Appendix A to this paper.
23. Staff have also drafted paragraphs for the Basis for Conclusions (paragraphs BC26-27 of the [draft] ED) which are provided as Appendix B to this paper.

Decision(s) required

The IPSASB is asked whether it agrees with:

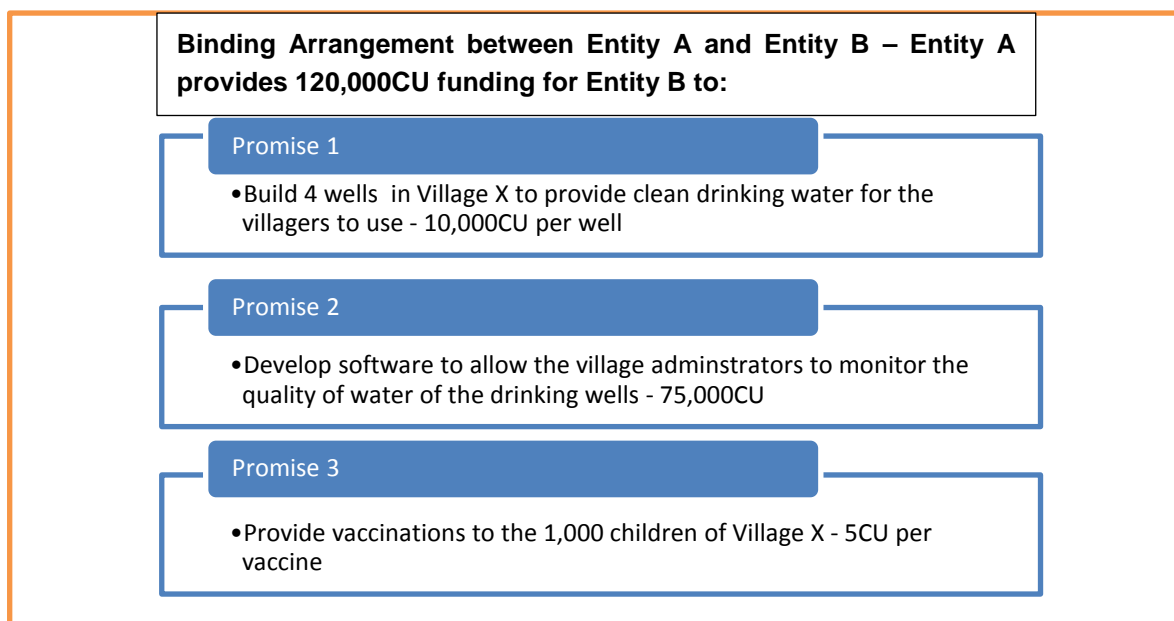
- (a) The Application Guidance on *Identifying a Performance Obligation in a Binding Arrangement*;
- (b) The placement of this Application Guidance at paragraphs AG29-44 of the [draft] ED;
- (c) The Basis for Conclusions paragraphs; and
- (d) The placement of the Basis of Conclusion paragraphs BC26-BC27 of the [draft] ED.

Identifying a performance obligation in a binding arrangement

- 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).

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).
- 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.



- 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.
- 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.

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.
- 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 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.