

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

**Meeting Location:** Toronto, Canada

**Meeting Date:** June 18–21, 2019

**From:** Joanna Spencer

## Agenda Item 11

For:

☐ Approval

☒ Discussion

☐ Information

### [DRAFT] ED 71, *REVENUE WITHOUT PERFORMANCE OBLIGATIONS*

<b>Project summary</b>	The aim of this project is to update IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i> and replace with a new IPSAS.	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Project management</b>	<a href="#">Revenue without Performance Obligations Road Map</a>	<a href="#">11.1.1</a>
	<a href="#">Decisions up to March 2019 Meeting</a>	<a href="#">11.1.2</a>
	<a href="#">Instructions up to March 2019 Meeting</a>	<a href="#">11.1.3</a>
<b>Decisions required at this meeting</b>	<a href="#">Revenue Options</a>	<a href="#">11.2.1</a>
	<a href="#">Capital Grants</a>	<a href="#">11.2.2</a>

**REVENUE WITHOUT PERFORMANCE OBLIGATIONS ROADMAP**

<b>Meeting</b>	<b>Objective: IPSASB to consider:</b>
June 2019	Discussion of Issues Develop Exposure Draft
September 2019	Approve Exposure Draft
December 2019	
March 2020	
June 2020	Review Responses
September 2020	Discuss Issues
December 2020	Discuss Issues/Develop IPSAS
H1 2021	Approve IPSAS

# Agenda Item

## 11.1.2

### DECISIONS UP TO MARCH 2019 MEETING

Date of Decision	Decision
March 2018	The Board agreed that in regards to revenue the terms 'exchange' and 'non-exchange' in IPSAS 23 should be replaced with terms articulating performance obligation/no performance obligation but staff should consider the appropriateness of each particular change.
December 2018	Enforceability is the determining factor as to which IPSAS a transaction will be address • Enforceable – IFRS 15 based IPSAS • Not enforceable – Updated IPSAS 23.
December 2018	Transactions that are not enforceable, but which have intentions/expectation are to be recognized when the revenue is receivable but are to communicate these intentions/expectations via enhanced display/disclosure - (Option a)
June 2018	The Board decided not to change the existing recognition requirements for recognizing services in-kind from those already existing in IPSAS23. But to add an encouragement for entities to provide disclosure of qualitative information about volunteers' services received.
March 2018	The Board decided that IPSAS 23 should be updated.
June 2017	All decisions made up until June 2017 or earlier were reflected in the <a href="#">Consultation Paper, Accounting for Revenue and Non-Exchange Expenses</a> .

# Agenda Item

## 11.1.3

### INSTRUCTIONS UP TO MARCH 2019 MEETING

Meeting	Instruction	Actioned
March 2019	Make the changes to terminology (exchange/non-exchange) but ensure that the messaging is accurate.	Ongoing
March 2010	Staff are to update the IPSAS 23 flowchart to refer only to 'Use IPSAS 23' and not pre-empt the accounting treatment.	Agenda Item 11.2.1
March 2018	To consider if there are any transactions that are enforceable but have obligations but no 'performance obligations' and possible treatment of such transactions.	Agenda Item 11.2.1
March 2019	Develop accounting treatment for unenforceable transactions to be included in an updated IPSAS 23.	Agenda Item 11.2.1
March 2019	Staff are to prepare a [draft] updated IPSAS 23 for consideration at the June 2019 Board meeting including drafting on: • Capital and research grants • Presentation • Enforceable transactions with obligations (not performance obligations) • Taxes • Appropriations.	To be addressed in September 2019
December 2018	The Board directed staff to develop enhanced display/disclosure requirements to communicate performance and/or intentions/expectations for unenforceable transactions.	To be addressed in September 2019
December 2018	The Board directed staff to develop guidance on when an entity has control of a resource including discussions on: • Appropriations; • Budgets; • Multi-year funding.	To be addressed in September 2019
September 2018	The Board instructed staff to consider the NZ requirements for providing qualitative disclosures for entities that are reliant of services in-kind for their operations.	
June 2018	The Board instructed staff is to provide options on how wording and placement of such encouragements to recognize or disclose services in-kind would appear in an updated IPSAS 23.	
June 2018	Re Services in Kind, staff is to consider Australian and South African requirements for services in-kind and any examples provided by Board members.	
March 2018	The Board directed staff to re-examine respondent comments to the CP regarding services in-kind and to shape the argument for each option.	
March 2018	The Board directed staff to conduct research on services 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.	

## Agenda Item 11.1.3

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</i> , <i>Updated IPSAS 23</i> and <i>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 <a href="#">Consultation Paper, Accounting for Revenue and Non-Exchange Expenses</a> .	

# Agenda Item

## 11.2.1

### Revenue without Performance Obligations – Revenue Options

#### Questions

1. The Board is asked to agree that enforceable transactions without performance obligations (which will be addressed in [draft] Exposure Draft ED 71, *Revenue without Performance Obligations*), but with 'terms'<sup>1</sup> as to how the resources are to be used should be recognized as revenue when receivable.

#### Detail

2. The Consultation Paper (CP), [Accounting for Revenue and Non-Exchange Expenses](#), identified a number of application issues with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. These included:
  - (a) The difficulty in making the distinction between exchange and non-exchange transactions;
  - (b) Problems in distinguishing between conditions and restrictions; and
  - (c) The absence of guidance on accounting for capital grants (considered separately in [Agenda Item 11.2.2](#)).
3. Having reviewed the CP responses, the Board decided that identification of whether a transaction contains a performance obligation is more clear-cut than assessing whether it is exchange or non-exchange. The IPSASB has previously decided that revenue transactions that arise from a binding arrangement and contain performance obligation(s) should be accounted for under [draft] ED 70, *Revenue with Performance Obligations*. [Draft] ED 70 has also been 'expanded through the inclusion of application guidance to address non-contractual situations in the public sector where there is a binding arrangement rather than a contract. It has further been expanded to include enforceability mechanisms by equivalent means, and a sufficiently specific promise within a binding arrangement (the Public Sector Performance Obligation Approach (PSPOA)).
4. The development of two EDs [draft] ED 70, *Revenue with Performance Obligations* (which is based on IFRS 15, *Revenue from Contracts with Customers*), and [draft] ED 71, (which will be an updated IPSAS 23) is therefore intended to resolve issue 2(a). This is because the basis for classifying transactions will be whether or not they have a performance obligation, rather than whether the transaction is exchange or non-exchange.
5. The problems in distinguishing between conditions and restrictions should also be resolved by the development of the two new IPSAS, because conditions in IPSAS 23 (are similar to, although broader than, performance obligations in [draft] ED 70). Both a performance obligation and a condition are enforceable. Further, both a performance obligation and a condition provide specificity around what the resources are to be used for – a performance obligation requires a good or service to be separately identifiable, and a condition needs to specify such matters as the nature or quantity of goods and services to be provided. Therefore, the staff view is that in general, an [draft ED 70]

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<sup>1</sup> Staff have used the word 'terms' to indicate that the purchaser has indicated how the resources are to be used. The Board directed at the December 2018 meeting the phrase 'time requirements' is not used, as requirements misleadingly implies enforceability and staff have tried to avoid using stipulations, restrictions and conditions as these are defined terms in IPSAS 23.

'performance obligation' will be very similar as an IPSAS 23 'condition' and should be accounted for under [draft] ED 70.

### **Revenue Transaction Types**

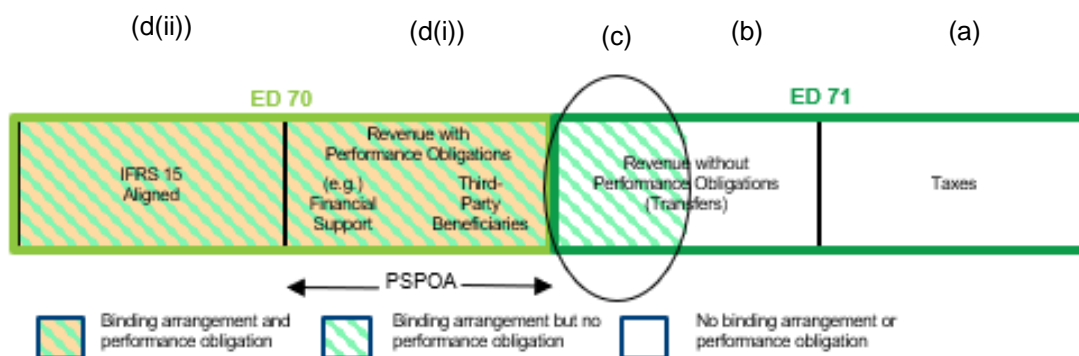
6. Staff have identified four generic types of revenue transactions based on their characteristics as follows:
- (a) Non-enforceable transactions with no performance obligations and no 'terms' related to the usage of the resources;
  - (b) Non-enforceable transactions with no performance obligations but with 'terms' related to the usage of the resources;
  - (c) Enforceable transactions with no performance obligations but with 'terms' related to the usage of the resources; and
  - (d) Enforceable transactions with performance obligations related to the usage of the resources.
7. The following table analyses the characteristics of these generic types of transactions:

	<b>Example</b>	<b>Enforceable by way of a binding arrangement</b>	<b>Performance Obligation</b>	<b>Terms related to usage of resources</b>	<b>Comments</b>
(a)	Taxes, Fines	No	No	No	Falls within scope of ED 71
	General Donation	No	No	No	Falls within scope of ED 71
(b)	Donation for a specific purpose	No	No	Yes – for a specific purpose	Falls within scope of ED 71. No binding arrangement therefore not enforceable. Intended use of funds could be communicated through presentation or note disclosure.

	Example	Enforceable by way of a binding arrangement	Performance Obligation	Terms related to usage of resources	Comments
(c)	(i) Fund an outcome focused specific project (e.g. improve the quality of drinking water)	Yes	No	Yes – for a specific purpose	Falls within scope of ED 71. Enforceable binding arrangement. However, no performance obligation as the goods or services to be delivered are not separately identifiable.
	(ii) Research Grant where the entity keeps the intellectual property	Yes	No	Yes – for a field of research	Falls within scope of ED 71. Enforceable binding arrangement. However, no performance obligation because the transaction does not result in a transfer of a good or service to the entity giving the grant or a third-party beneficiary
(d)	(i) Provision of laptop computers to all children in the government education system – funding from Central Government to Education Department (State Government) who will purchase and distribute the laptops to government schools	Yes	Yes	N/A	Apply [draft] ED 70, <i>Revenue with Performance Obligations</i> – (Expanded to include public sector specific transactions such as those that involve three parties)
	(ii) Purchase of four fighter jets	Yes	Yes	N/A	Apply [draft] ED, 70 <i>Revenue with Performance Obligations</i>

11. The diagram below illustrates the interaction between ED 70 and ED 71, as well as where the transactions in the table above would fall in the 'spectrum' of transactions that they cover. The transactions which are the main focus of this paper are also circled.

### Revenue Recognition Principles



### The Debit

12. Upon the receipt of a resource, a recipient recognizes a receivable (from a binding arrangement) or cash received (from an unenforceable arrangement as an asset in the financial statements. The flowchart reflects a theoretical possibility that an inflow might be an 'other resource'<sup>2</sup>, although staff cannot envision circumstances where this would arise.

### The Credit

13. Revenue is defined in paragraph 5.29 *The Conceptual Framework for General Purpose Reporting by Public Sector Entities* (the Framework) as:

'Increases in the net financial position of the entity, other than increases arising from ownership contributions.'

An increase in the entity's financial position occurs either through gaining control of an asset or a reduction in a liability.

14. An asset is defined in the framework as:

'A resource presently controlled by the entity as a result of a past event'.

15. Revenue is recognized immediately unless the transaction includes terms in the arrangement that gives rise to a liability. Therefore, for revenue to be deferred a liability must exist at the inception of the agreement.

16. A liability is defined in The Framework as:

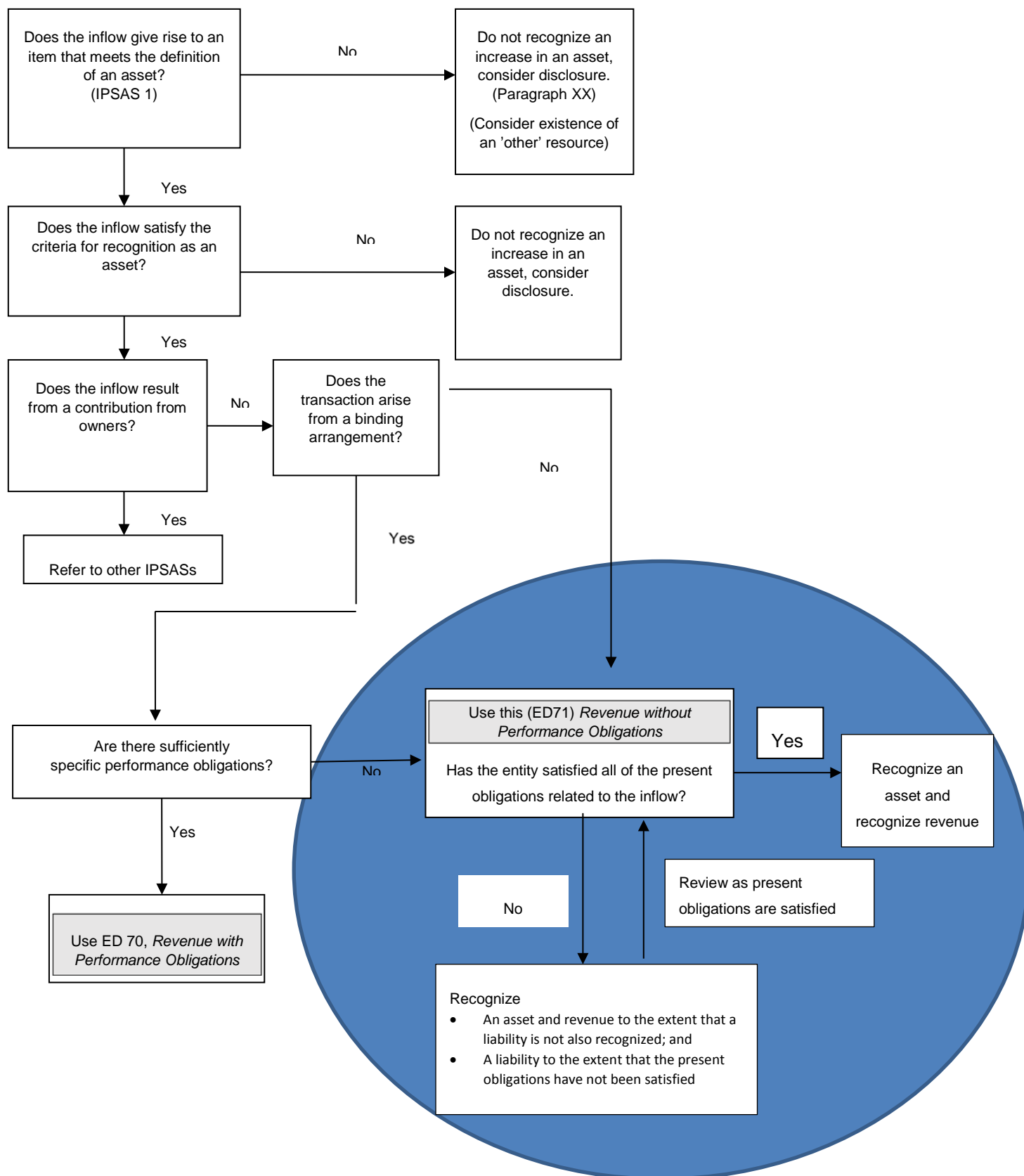
'A present obligation of the entity for an outflow of resources that results from a past event'.

The Conceptual Framework acknowledges, that to achieve the objective of financial reporting, in some circumstances a resource or an obligation that does not satisfy the definition of an element (asset or liability) may need to be recognized in the financial statements – these are called 'other resources' and 'other obligations'. These items have not, as yet, been used at standards level.

17. Under the Framework, if a transaction does not give rise to a liability, revenue is recognized immediately because the entity controls the resources as the result of a past event, unless there is standards-level guidance allowing or requiring the item to be reported as an 'other obligation'. The Framework allows the IPSASB, in developing or revising an IPSAS, to determine that, in order to achieve the objectives of financial reporting, a resource or obligation that does not satisfy the definition of an element should be recognized as an 'other resource' or an 'other obligation'
18. Under the Conceptual Framework, the three possible alternative approaches to revenue recognition are:
  - (a) Record the credit as revenue upon receipt (hereafter referred to as "immediate revenue recognition" for brevity); or
  - (b) Record the credit as a liability upon receipt, then recognize amounts as revenue with reference to the terms of the agreement (hereafter referred to as the "deferral of revenue" for brevity); or
  - (c) Record the credit as an 'other obligation' upon receipt, which is also a 'deferral of revenue' approach.

#### **Revenue recognition under [draft] ED 71**

19. This section now considers the three generic transaction types that need to be considered in [draft] ED 71, *Revenue without Performance Obligations* (types (a) to (c)). As mentioned in paragraph 3 revenue transactions that are enforceable and contain a performance obligation(s) will be addressed in the [draft] ED 70, *Revenue with Performance Obligations* and therefore require no further discussion in this paper.
20. Staff have updated the flowchart from IPSAS 23 to show firstly the decisions required to determine which standard should be applied (the Board saw this as a slide at the March meeting), and added for this meeting the additional boxes in the circled / shaded area from the IPSAS 23 flowchart that could be required in the ED 71 update, depending on the decisions that the Board takes at this meeting, which are circled.



*Type (a) transactions*

21. At the December 2018 meeting, the IPSASB decided that if a transaction is unenforceable then revenue is recognized immediately. There is no liability and no deferral of revenue.

*Type (b) transactions*

22. These transactions are also unenforceable because there is no binding arrangement. Therefore, revenue is recognized immediately. However, this transaction has terms indicating how the resource provider wants the funds to be used. For example; in the case of a donation provided to an aid organization following a natural disaster, the lack of a binding arrangement means that the recipient cannot be compelled to use the resources in accordance with any donor intentions.
23. The Board decided that the terms on how a donation was meant to be used could be useful information for users of the financial statements and the presentation and disclosure options should be considered in such a case.

*Type (c) transactions*

24. At the March 2019 Board meeting, staff were instructed to consider if there are any transactions that are enforceable but have terms that are not performance obligations (as defined in draft [ED] 70) and to develop the possible accounting treatments for further consideration by the IPSASB.
25. Following is an example of a category (c) transaction:

**Fund an outcome focused specific project** – resources are provided to improve the drinking water of a community but there are no specific outputs in the agreement. If the funds are not used for this purpose, there is an enforceable consequence for the entity (either repayment of funds or some other penalty). Transactions related to this funding do not include performance obligations because there are no separately identifiable goods and/or services to be transferred.

26. How should enforceable transactions with terms as to how the resources should be used be accounted for? There are differing views, and these are discussed below.

*View 1 – Immediate Revenue Recognition*

27. Because there is no specificity about the goods and services to be delivered, no present obligation exists because performance cannot be measured against the terms of the agreement. Revenue should therefore be recognized immediately, as for type (a) and (b) transactions.
28. Proponents of this view argue that the past event that might give rise to a liability would be a breach of the agreement if the funds were not used at some future stage as required under the grant agreement, rather than the terms in the agreement at its inception. In this case, the recipient can always avoid a sacrifice of resources by acting in accordance with the general terms of the agreement. Therefore, no liability exists at the inception of the agreement and revenue recognition cannot be deferred.

*View 2 – Deferral of revenue*

29. As noted in paragraph 13 to defer revenue recognition a liability must exist. Therefore, a present obligation must exist for an outflow of resources as a result of a past event.

30. If the Board rejects View 1 as it believes there is a liability at the start of the agreement, then the question arises as to how / when revenue should be recognized. Under this view there are several options for revenue recognition.
- (a) Option 1 – The recipient of the resources recognizes a liability but does not recognize any revenue until the end of the agreement or the funds have been exhausted. The rationale would be that the signing of the agreement is the past event and the recipient is liable for an outflow of resources (to the resource provider or a third-party beneficiary) until the recipient has fully met the requirements of the agreement.
  - (b) Option 2 – The recipient of the resources recognizes a liability and recognizes revenue on a straight-line or other systematic basis – this has been described recently as the consumption approach. The rationale would be that the signing of the agreement is the past event and the recipient has a present obligation for an outflow of resources (to the resource provider or a third-party beneficiary). Supporters of this approach consider that it provides information that is more relevant and faithfully representative of an entity's financial performance and financial position than Option 1 as revenue is recognized in accordance with the operational activities of the recipient. This approach was explicitly rejected by the Board at its March meeting.
  - (c) Option 3 – The recipient of the resources recognizes an 'other obligation' and does not recognize the revenue until the end of the agreement or the funds have been exhausted. Unlike Option 2 supporters of this view accept that there is no liability because the signing of the agreement does not give rise to a present obligation for an outflow of resources, as the recipient can avoid the sacrifice of resources by using the funds in accordance with the general provisions of the agreement. Similarly, to Option 2 supporters of this option consider that it provides relevant information that faithfully represents the financial position and financial performance of the recipient. Immediate recognition of revenue does not provide such information.
31. There is a further possible option if the agreement has specific milestones, so that if the recipient of the grant does not achieve these milestones the resource provider can recover the funds or take other enforcement actions, which is not the case with the drinking water example in paragraph 21. This is exemplified using a research grant with the following fact pattern (example c(ii) in the transaction types table above):

**Research grants where the entity receiving the grant keeps the intellectual property** – for example, funding is provided to a research university to conduct research in a specific field (e.g., cancer research). A detailed project plan of how the funds are to be used (tests, reports etc.) is part of the binding arrangement. If the funds are not used as specified there is an enforceable consequence for the university (either repayment of funds or some other penalty). The intellectual property gained from this research is retained by the university. Therefore, there is no performance obligation because there is no transfer of goods or service to the purchaser or a third-party beneficiary

- (a) Option 4 – The recipient of the resources recognizes a liability and recognizes revenue when milestones set out in the agreement are achieved. The rationale is that the signing of the agreement is the past event and the recipient is liable for an outflow of resources (to the resource provider). However, if the recipient does not use the funds as specified the provider

can recover the funds at specified stages of the arrangement. This may be considered as using the [draft] ED 70 approach by analogy.

32. The table provided at the Appendix summarizes the advantages and disadvantages of each of these options.

#### **Staff Recommendation**

33. Staff recommend that for transactions that are enforceable but do not have performance obligations (as defined in [draft] ED 70) revenue should be recognized when receivable (View 1) because the recipient can avoid a sacrifice of resources by acting in accordance with the general terms of the agreement.

#### **Questions for the Board**

34. Does the Board agree with the staff recommendation in paragraph 33?
35. If the Board does agree with the staff view, then could the boxes in the shaded circle in the flowchart (following paragraph 20) be replaced with a single box stating, 'Recognize an asset and recognize revenue'?

# Appendix

	<b><u>Immediate Revenue Recognition</u></b>	<b><u>Deferral of Revenue Approaches</u></b>			
	Revenue is recognized when receivable by the recipient	Option (1) Revenue recognized when terms of the arrangement are completely fulfilled	Option (2) Revenue recognized on a straight-line or other systematic basis	Option (3) Recognize an 'other obligation' and then recognize revenue when the terms of the arrangement are fulfilled	Option (4) Revenue recognized as milestones in the agreement are met
<b>Advantages (as claimed by supporters)</b>	In accordance with the Framework as no liability of the recipient.	Entity has a liability until all the terms of the arrangement are fulfilled	Provides relevant information that faithfully represents the financial position and financial performance of the recipient	Provides relevant information that faithfully represents the financial position and financial performance of the recipient	Provides information on a recipient's liabilities and revenue.
	Can address problem of up-front revenue recognition through appropriate disclosure.	Faithfully represents the ability of the resource provider's right to recover funds if they are not used as per the terms of the agreement.	Better reflects the operational activities of the recipient and use of funding.	While achieving a similar outcome as Option 2 more transparent as it acknowledges that no liability arises.	In the resource recipient's statements faithfully represents resource provider's right to recover funds if they are not used as per the 'terms' of the agreement.  Better reflects the operational activities of the recipient and use of funding

## Revenue

IPSASB Meeting (June 2019)

<b>Disadvantages (as claimed by those not supporting)</b>	Introduces volatility into the financial statements as revenue recognized up front in reporting periods when agreements are signed.	<b>Highly questionable whether there is a liability, as recipient can avoid a sacrifice of resources by acting in accordance with the general provisions of the agreement.</b>	<b>Highly questionable whether there is a liability of the recipient.</b>	Involves the recognition of an item that is not an element. 'Other Obligations' has not been used at standards level before. Despite their acknowledgement in the Conceptual Framework some have reservations about the conceptual robustness of 'other resources' and 'other obligations'	Highly questionable as to whether there is a liability as 'terms' are not performance obligations and so do not give rise to liabilities.
		Funds are only repayable at the end of the agreement if they are not used as per the 'terms' of the agreement, so repayment can be avoided by performance in terms with the agreement, so only contingent during the agreement period until there is non-performance.	Seen as a matching approach linking revenue recognition to timing of expense recognition and inconsistent with IPSASB's Framework and literature. The Board therefore explicitly rejected this approach at its March meeting.	Allows entity to recognize an asset up front, so increasing its net assets without having to perform at all, as net obligations	

# Agenda Item

## 11.2.2

### Revenue without Performance Obligations – Capital Grants

#### Questions

1. The Board is asked to direct staff as to which method of accounting is most appropriate for recognition of revenue in relation to capital grants.

#### Detail

2. At the March 2019 IPSASB meeting, the Board confirmed that transactions that are enforceable but do not have performance obligations as defined in [draft] Exposure Draft 70 (ED 70), *Revenue with Performance Obligations* are to be accounted for under [draft] Exposure Draft 71 (ED 71), *Revenue without Performance Obligations*.
3. A performance obligation is defined in [draft] ED 70 as:
 

A promise in a binding arrangement with a purchaser to transfer to the purchaser or a third-party beneficiary either:

  - (a) A good or service (or a bundle of goods or services) that is separately identifiable; or
  - (b) A series of separately identifiable goods or services that are substantially the same and that have the same pattern of transfer to the purchaser.
4. Generally, a capital grant would be provided in a binding arrangement (and therefore would be enforceable). However, because of their nature capital grants do not include performance obligations as defined in [draft] ED 70, because the capital asset financed by the grant is not transferred to the purchaser or a third-party beneficiary.
5. Capital grants give rise to a subset of enforceable transactions that have obligations that do not meet the definition of a performance obligation in [draft] ED 70. Therefore, they would be accounted for under [draft] ED 71.
6. The term “capital grant” is not defined in the current IPSAS literature. Historically, the IPSASB has used the term “capital grant” to refer to capital transfers as defined in the Government Financial Statistics Manual (GFSM).
7. The term “transfer” is defined in the United Nations System of National Accounts (SNA) and GFSM as: “... a transaction in which one institutional unit provides a good, service, or asset to another unit without receiving from the latter any good, service, or asset in return as a direct counterpart.”
8. The SNA and GFSM further specify that a capital transfer involves the transfer of an asset, or the transfer of cash with a requirement that the recipient acquire or construct an asset.
9. Combining the above concepts, a “capital grant” can be defined as, “a transaction in which one entity (the grantor) provides an asset, or cash with a requirement that the recipient acquire or construct an asset, without receiving from the recipient any good, service, or asset.”
10. At present, IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* does not provide accounting requirements for capital grants specifically, although one of the illustrative examples in IPSAS 23 relates to capital grants.

11. The Consultation Paper, *Accounting for Revenue and Non-Exchange Expenses*, proposed in Preliminary View (PV) 4 that accounting for capital grants should be explicitly addressed in IPSAS. Eighty-two percent of respondents either agreed (71%) or partially agreed (11%) with the PV, and 18% of respondents did not comment. Current practices
12. Requirements for the accounting for capital grants some international and national accounting standards are in the attached Appendix. In summary:
  - (a) IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* requires a grant related to assets to be recognized over the life of the asset as a reduction in depreciation. Entities can choose to present the grant either as deferred income or by deducting the grant in arriving in the carrying amount of the asset.
  - (b) FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* allows use of a performance model or an accrual model. The performance model requires the grant to be recognized as income when the performance-related conditions are met, if there are no performance-related conditions the grant is recognized when the entity has control of the resources. The accrual model requires income to be recognized on a systematic basis over the expected useful life of the asset.
  - (c) AASB 1058 *Income of Not-for-Profit Entities* requires an entity to recognize income when (or as) the entity satisfies the obligations under the transfer. This approach is analogous to the AASB 15 (IFRS 15) performance obligation approach.

### ***Accounting for Capital Grants***

13. As noted in paragraph 12 there are diverse methods for accounting for capital grants. The main purpose of this paper is to decide the most appropriate method in the public sector.
14. On receipt of resources that are intended for the entity to procure a capital asset, an asset is recorded for those resources. This is the debit entry but what should the corresponding credit entry be – there are varying views which are discussed below?

### **Immediate Recognition**

15. As noted in [Agenda Item 11.2.1](#), the Board decided that revenue is recognized immediately for unenforceable revenue transactions. Therefore, resources related to a capital grant that is unenforceable will be recognized when the entity controls those resources.
16. However, staff are of the view that most capital grant transactions will result from a binding arrangement and therefore would be enforceable. Despite these transactions being enforceable some may argue that because there is no performance obligation due to there being no transfer of an asset to either the purchaser or a third-party beneficiary there is no present obligation which creates a liability. This is because a present obligation to return resources would only be created if and when an entity breached the terms of the agreements. Advocates of this view consider specifications in the capital grant agreement may give rise to a contingent liability, which is disclosed in the notes to the financial statements.

Defer Recognition

17. Others may argue that the only reason a capital grant would not be accounted for under [draft] ED 70 is that there is no 'transfer' of resources, and that, in substance, a requirement to build or acquire a capital asset is the same as a performance obligation. Therefore, revenue should be deferred. If this view is taken how and when should revenue be recognized? Staff consider that are three possible patterns of revenue recognition:
- (a) Recognize over the period of construction;
  - (b) Recognize in accordance with any specific requirements of the agreement; or
  - (c) Recognize over the life of the asset.

*Recognize over the period of construction*

18. If the terms of the arrangement were not specific it might be appropriate to recognize revenue on a systematic basis such as a straight-line basis or at specific stages of completion. This option addresses constituents' concerns about a mismatch between revenue recognition and the consumption of resources. However, some advocates consider this presents relevant and faithfully representative information. Further, it may be argued that the consumption of resources is a proxy for performance against the non-specific terms of the arrangement.
19. For example, the terms of a capital grant may have a general requirement to complete the construction of a building over a specific period, but the arrangement does not provide details such as key milestones or the order in which major construction activities are to occur. Under this scenario revenue would be recognized over the specified construction period.

*Recognize in accordance with any specific requirements of the agreement*

20. This option is analogous with the accounting in [draft] ED 70 in that a liability is recognized when the capital grant becomes receivable and revenue is recognized over the performance period based on the terms in agreement. The accounting requirements for these transactions would need to be narrow so only enforceable capital grants with arrangements that include terms that are sufficiently specific are captured.
21. For example, a capital grant requires the construction of a building, and the agreement sets out details such as the specific activities to be performed by the resource recipient, the timing of such activities, and mechanisms for the assessment of progress. The terms also state that failure to meet the requirements would result in a full or partial refund of the grant, depending on what activities have been satisfactorily performed to date. Under this scenario revenue would be recognized as specific activities have been performed.

*Recognize over the life of the asset*

22. Some may also argue that a capital grant is provided to construct or procure a capital asset and then to use that asset for service delivery. Therefore, the grant should be recognized as revenue for the period the asset is intended to be used. The enforcement of the arrangement could be at two points, if the entity failed to construct or procure a capital asset or when if the entity ceased to use the asset for the purpose specified in the agreement.

23. For example, a capital grant is provided to an entity to construct a building and then use that building as an early learning center for 20 years. Under this option the grant would be recognized over the construction period and the 20 years it is used for the specific purpose.
24. Staff are aware that this scenario is common in the UK in relation to social housing grants. The grant is provided to build and provide low cost housing. If the housing ceases to be used for that purpose the grant is repayable to the purchaser. However, staff are also aware that some social housing associations never recognized the grant as revenue as they considered the 'repayable' clause to be a perpetual liability.

#### **Staff recommendation**

25. Staff consider that in substance an enforceable capital grant transaction does have obligations that gives rise to a liability, Staff therefore recommend that revenue related to capital grants should initially be deferred, and then subsequently recognized by analogy with [draft] ED 70 either:
  - (a) according to the specific requirements of the arrangement; or
  - (b) over the period of construction on a systematic basis if the arrangement does not include specific requirements
26. Staff reject the view that revenue should be recognized immediately because as stated above staff considers a liability exists which requires deferring revenue. Staff also reject the approach that revenue should be recognized over the period of intended use of the asset. In the scenario described in paragraph 23, staff are of the view that two obligations exist, one to construct the building and the second to use the building for a specific purpose for 20 years. The capital grant actually relates to the first obligation and revenue should therefore be recognized in relation to that part of the agreement, rather than the ongoing (i.e. not present) obligation to continue to use it for a specific purpose.

#### **Questions for the Board**

27. Does the IPSASB agree with the staff recommendation in paragraph 25?

**International Financial Reporting Standards (IFRS)**

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* provides accounting 'grants related to assets' which are defined as:

Government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Paragraph 12 of IAS 20 requires government grants to be recognized in profit or loss on a systematic basis over the period in which the entity recognizes as expenses the related costs for which the grants are indented to compensate. Therefore, the grant is only recognized as the asset is depreciated.

IAS 20 allows the presentation of grants related to assets to be either, deferred income or by deducting the grant in arriving at the carrying amount of the asset.

In summary a grant related to asset under IAS 20 would never be classified as revenue, even though it affects the profit and loss statement as reduced depreciation.

**United Kingdom – Financial Reporting Standards (FRS)**

FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is based on the IASB's IFRS for SMEs (with some modifications). Section 24, *Government Grants* requires government grants to be recognized on either a performance model or an accrual model.

The performance model requires grants with no specified future performance-related conditions to be recognized by the recipient as income when the grant proceeds are received or receivable. A grant that imposes specified future performance-related conditions on the recipient in income only when the performance-related conditions are met.

The accrual model is similar to IAS 20 in that grants relating to assets shall be recognized in income on a systematic basis over the expected useful life of the asset. However, where part of a grant relating to an asset is deferred it shall be recognized as deferred income and not deducted from the carrying amount of the asset.

**Australia – Australian Accounting Standards**

AASB 1058, *Income of Not-for-Profit Entities* provides guidance on 'Transfers to enable an entity to acquire or construct a recognizable non-financial asset to be controlled by the entity'. Paragraphs 15 -17 state:

- 15 A transfer of a financial asset to enable an entity to acquire or construct a recognizable non-financial asset that is to be controlled by the entity is one that:**
- (a) requires the entity to use that financial asset to acquire or construct a recognizable non-financial asset to identified specifications;**
  - (b) does not require the entity to transfer the non-financial asset to the transferor or other parties; and**
  - (c) occurs under an enforceable agreement.**

- 16 An entity shall recognise a liability for the excess of the initial carrying amount of a financial asset received in a transfer to enable the entity to acquire or construct a recognisable non-financial asset that is to be controlled by the entity over any related amounts recognised in accordance with paragraph 9<sup>3</sup>. The entity shall recognise income in profit or loss when (or as) the entity satisfies the obligations under the transfer.**
- 17 In such circumstances, the transferor has in substance transferred a recognisable non-financial asset to the entity. The entity recognises the financial asset received in accordance with AASB 9 and subsequently recognises the acquired or constructed non-financial asset in accordance with the applicable Australian Accounting Standard (eg AASB 116 for property, plant and equipment). This Standard requires the entity to initially recognise a liability representing the entity's obligation to acquire or construct the non-financial asset and, if applicable, other performance obligations under AASB 15, which involve the transfer of goods or services to other parties. The liability in relation to acquiring or constructing the non-financial asset is initially measured at the carrying amount of the financial asset received from the transferor that is not attributable to related amounts for performance obligations under AASB 15, contributions by owners, etc. The liability is recognised until such time when (or as) the entity satisfies its obligations under the transfer.

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<sup>3</sup> Paragraph 9 states:

On initial recognition of an asset, an entity shall recognise a related contributions by owners, increases in liabilities, decreases in assets and revenue (related amounts) in accordance with other Australian Accounting Standards. For example, related amounts may take the form of:

- (a) *contributions from owners*, in accordance with AASB 16 [*Property, Plant and Equipment*];
- (b) revenue or a contract liability arising from a contract with a customer, in accordance with AASB 15 [*Revenue from Contracts with Customers*];
- (c) a lease liability in accordance with AASB 16;
- (d) a financial instrument, in accordance with AASB 9 [*Financial Instruments*]; or
- (e) a provision, in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.