

**Meeting:** International Public Sector Accounting Standards Board  
**Meeting Location:** Toronto, Canada  
**Meeting Date:** September 22–25, 2015  
**From:** David Bean and Todd Beardsworth

## Agenda Item 7

For:  
 Approval  
 Discussion  
 Information

### Non-Exchange Expenses

#### Objective of Agenda Item

1. The objective of this session is to **seek feedback** from the IPSASB on the key issues that should be considered when reviewing the requirements for non-exchange expenses.
2. The IPSASB will have an opportunity to discuss the links between this project and the revenues project. Agenda item 7.1 considers the links between the two projects.

#### Material(s) Presented

Agenda Item 7.1 Issues Paper, *Intersection of projects on revenue and non-exchange expenses*

Agenda Item 7.2 Issues Paper, *Non-exchange expenses*

#### Action(s) Requested

3. The IPSASB is asked to **consider** the Matters for Comment presented in Agenda Items 7.1 and 7.2, and to **provide input and direction** on the way forward.

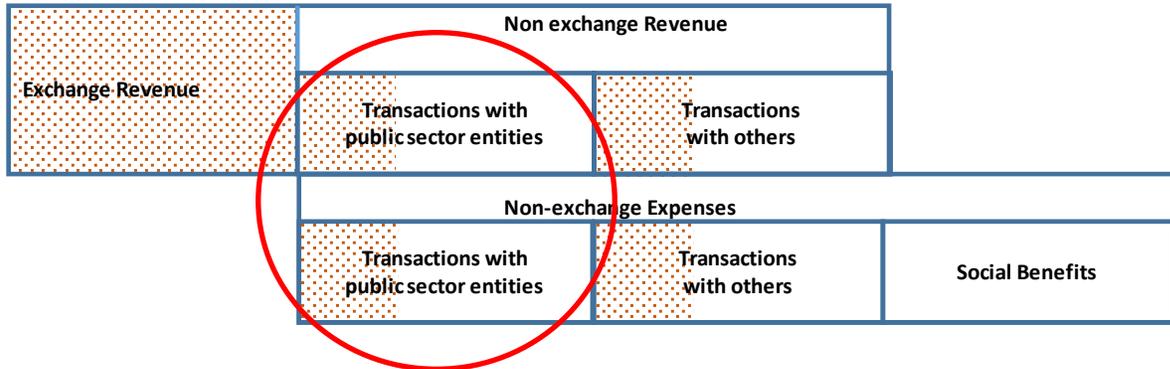
**ISSUES PAPER, *INTERSECTION OF PROJECTS ON REVENUE AND  
NON-EXCHANGE EXPENSES*****Background**

1. The IPSASB has previously noted that there would be some overlap between its projects on revenue and on non-exchange expenses. At the June meeting, the IPSASB asked that the two project teams work together to identify these overlaps and identify when symmetry in accounting for both sides of the transactions should be considered. The IPSASB also asked the project teams to develop some examples that could be used by both projects to assist the Board in understanding the links between the two topics. This paper responds to these requests.

**Main Areas Where Projects Intersect**

2. The main area where the projects will intersect is where one public sector entity provides resources to another public sector entity in a non-exchange transaction. This is where the non-exchange expense of one public sector entity becomes the non-exchange revenue of another public sector entity. These non-exchange transactions may or may not have performance obligations. On the expense side these types of transactions are often referred to as grants or transfers.
3. The staff consider that most transactions that are regarded as non-exchange expenses by the provider of resources would be regarded as non-exchange revenues by the recipient of the resources. However, until staff has done more work on the effect of performance obligations and other factors within the context of both projects, no recommendations have been developed regarding transaction classification or proposed recognition guidance at this point.
4. Two diagrams are used to try and explain the areas of common interest in the two projects. The first diagram shows the general intersection of the projects, while the second shows possible links between the revenues and expenses of various levels of public sector entities, beginning with a central government. It is hoped that the diagrams in this paper could be used at future meetings as a way of identifying which aspect of the interaction is being considered.

**Diagram 1 The Intersection of the Projects**



**Key to diagram**



Groups of transactions. Classifying transactions as exchange or non-exchange can be difficult in practice.

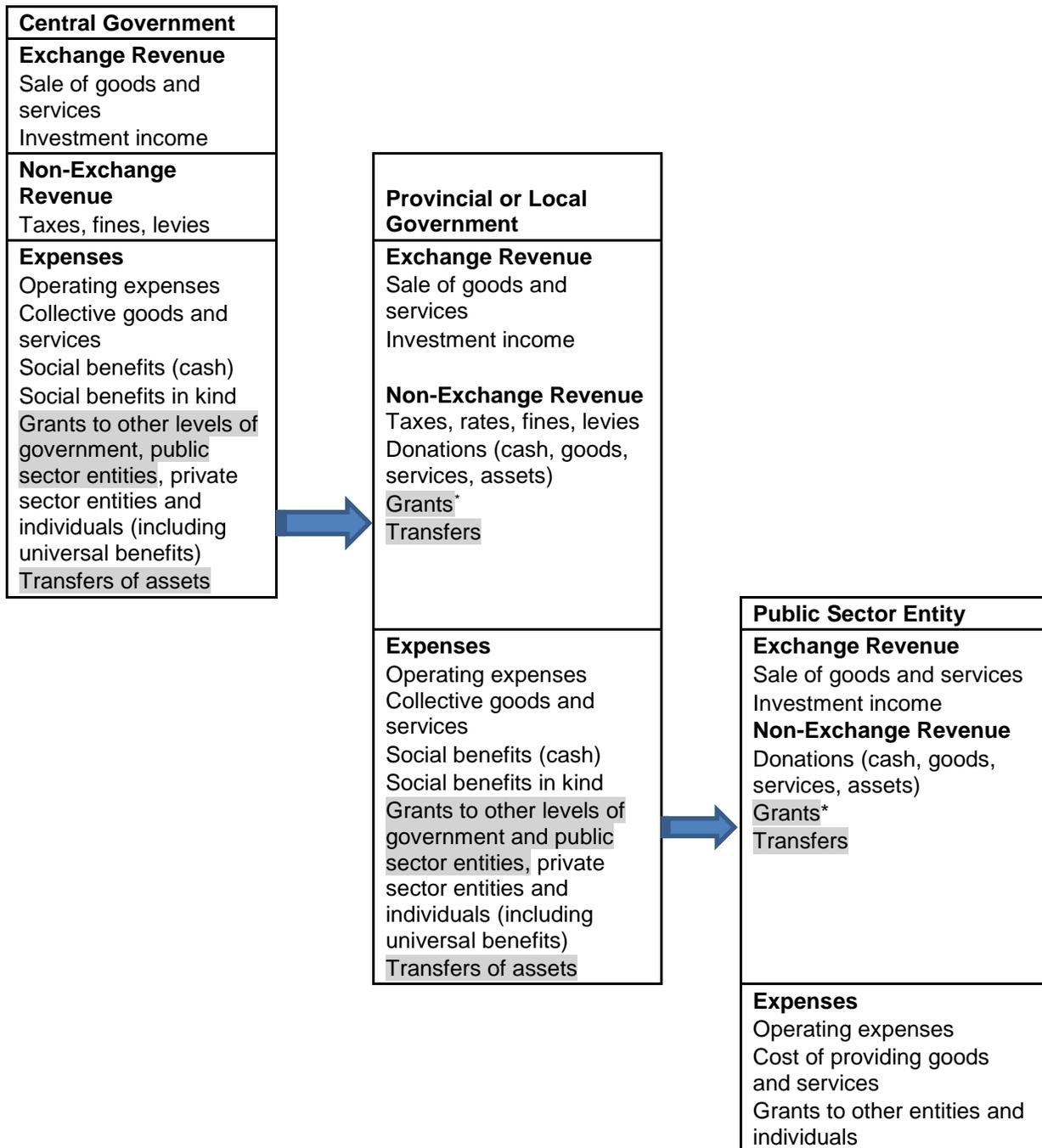


Transactions with some form of performance obligation



Area where the revenue project and the non-exchange expenses project intersect

**Diagram 2 Non-Exchange Transactions between Public Sector Entities**



**Notes on Diagram 2**

Grey shading shows possible non-exchange expenses leading to non-exchange revenue.

The social benefits project will also consider social benefits in cash and in-kind provided to individuals and households.

\* Revenue project will determine if some grants should be accounted for and reported as exchange revenue.

**Matter(s) for Consideration**

1. The IPSASB is asked to confirm that it agrees that the revenue project and the non-exchange expenses project are likely to intersect as indicated in diagrams 1 and 2.

**Examples of Transactions**

5. Staff have identified examples of transactions that could be a non-exchange expense for one party and non-exchange revenue for the public sector recipient. The examples are intended to cover the main areas where the revenue project and the non-exchange expenses projects intersect. The proposed examples are set out in Appendix A to this issues paper.
6. It is intended that these examples be considered in each project. The examples might need to be modified or added to as the projects progress.

**Matter(s) for Consideration**

2. The IPSASB is asked to confirm that the examples in Appendix A should be used in both the revenue project and the non-exchange expenses project to illustrate areas where the two projects intersect.
3. The IPSASB is asked to identify any further examples or variations of the examples that should be considered in both projects.

**Performance Obligations**

7. As illustrated in Diagram 1, some public sector transactions giving rise to revenue and expenses have performance obligations and both the revenue project and the non-exchange expenses project will need to consider the impact of performance obligations on the recognition of non-exchange transactions. Initial work on the revenue project has suggested that a performance obligation approach might be appropriate for some public sector revenue transactions. This paper uses the term performance obligations when describing the characteristics of non-exchange transactions. However, it uses the term in a broad manner. The performance obligations referred to in the proposed examples may not be specific enough in all cases for the performance obligation to drive the accounting approach.
8. For example, public sector transactions may not have clearly defined performance obligations. In addition, non-exchange transactions often have stipulations in the form of restrictions or conditions on the use of the resources transferred. One could argue that such stipulations represent performance obligations; while others believe that only certain stipulations should be considered performance obligations. The issue of defining a performance obligation in the context of the public sector, specifically considering conditions and restrictions, will be addressed at a future meeting.

**Matter(s) for Consideration**

4. The IPSASB is asked to confirm that the definition of performance obligation in the public sector should be considered at a future meeting.

## **Additional Factors**

9. Non-exchange transactions often have other characteristics (which this paper refers to as “additional factors”) that could affect the point at which revenue or expenses should be recognized. These additional factors also may help to clarify the definition of non-exchange transactions. These additional factors may include eligibility requirements (not including performance obligations), timing restrictions on the use of the transferred resource, and appropriation by the transferring public sector entity (that also may include timing restrictions).
10. To explore the differences between the additional factors and how those differences may affect recognition, project staff considered the examples from Appendix A to demonstrate how the additional factors may or may not affect the classification of the transaction as exchange or non-exchange. Through this consideration, the IPSASB can continue to evaluate potential recognition approaches and the issue of symmetrical accounting that affects both projects.

### **Matter(s) for Consideration**

5. The IPSASB is asked to confirm that the additional factors may affect recognition of a non-exchange transaction.
6. The IPSASB is asked to identify any other factors that should be considered in developing examples presented in Appendix A.

## **APPENDIX A: EXAMPLES**

The examples in this Appendix set out the details of the agreements for the Board's consideration. The examples are divided into four categories:

- (1) Performance obligations with no additional factors
- (2) Performance obligations with additional factors
- (3) No performance obligation with additional factors
- (4) No performance obligation with no additional factors.

### **Performance Obligations and No Additional Factors**

11. Non-exchange transactions between public sector entities can have performance obligations specified in the grant agreement with no additional factors to consider. This type of transaction is presented in Example 1.
12. To apply the obligating events approach, the following points could be considered to be the recognition event:
  - Grant agreement is entered into
  - As individual performance obligations are satisfied
  - Once the entire performance obligation is fully satisfied.
13. At the time of the grant agreement, the provider has indicated that they have the intent to fund the payment. At this point, the provider has given an indication to the recipient that the provider will accept responsibility to subsidize the activities described in the grant agreement. The recipient also has a valid expectation that resources will be provided to support the program or activity described in the grant agreement.
14. While entering into the grant agreement could be considered an obligating event, the public sector entity transferring resources has specified a performance obligation. Both project teams will consider how this performance obligation may affect recognition of the transaction. For example, if the performance obligation is not satisfied, does the recipient control resources? And does the provider have a binding obligation?
15. Some grant agreements may specify that the entire performance obligation must be met before funds will be provided. Other agreements may indicate that resources will be provided as the performance obligation is met – that is, the provider will pay a pro-rata amount for the portion of the performance obligation that is met out of the total performance obligation called for in the agreement. Agreements also may be silent as to the treatment of the partial satisfaction of the performance obligation. The terms of each grant agreement would need to be evaluated.
16. This approach is effective when performance obligations are clearly specified. As previously noted, identifying specific performance obligations may be difficult in certain public sector agreements or arrangements.

## **Performance Obligations With Additional Factors**

17. Non-exchange transactions may have both performance obligations and additional factors to consider. These factors include eligibility requirements, timing restrictions, and appropriations. This type of transaction is presented in Examples 2-4 and 9-10.

### **Eligibility Requirements**

18. Eligibility requirements may affect the recognition of non-exchange transactions with performance obligations. At the time the agreement is made, both the provider and recipient are usually aware of whether or not the eligibility requirement has been met by the recipient. If the recipient only has to meet the eligibility requirement at the time of the agreement, and does so, then the eligibility requirement may not affect the timing of recognition. If the recipient needs to meet the eligibility requirement throughout the agreement, the recipient could provide the services based on the performance obligation, but still not be in compliance with the grant agreement (which could be a factor in revenue and expense recognition).
19. If a performance obligation is present, one may still argue that there is no obligation to the provider to transfer resources to the recipient until that performance obligation also is met. Until that time, the public sector entity transferring resources has an alternative to avoid the outflow of resources. Based on this argument, even when the eligibility requirement was met, the grant agreement would not give rise to a liability to the public sector entity providing resources until the performance obligation is satisfied.
20. Although the recipient has a valid expectation that funds will be transferred, that expectation depends upon the satisfaction of the performance obligation (and may also depend on meeting the eligibility requirement throughout the grant agreement). If the recipient has not met the performance obligation at the time of the agreement, one could argue that the recipient does not have a binding obligation from the provider, nor does it control resources as a result of the grant agreement.
21. Some agreements may require a recipient to maintain eligibility throughout the time period of the agreement, or while the recipient satisfies the performance obligation. If a recipient were to no longer meet the eligibility requirements, but still continue to provide services, some would argue that only the costs incurred to the point the eligibility requirement was no longer met would be relevant. They would argue that the recipient must both provide the service to satisfy the performance obligation and remain eligible during that time to gain control of resources under the terms of the grant. The provider may have alternative to avoid the outflow if the recipient does not maintain eligibility. In some cases, the provider may be prohibited from granting funds to recipients who do not maintain eligibility. The recipient may not have control of resources in this case.

### **Timing Restriction**

22. Time requirements associated with the grant agreement also may affect the recognition of non-exchange transactions with performance obligations. The timing restriction is the requirement for the recipient to use the funds for the fiscal year (or fiscal years) that begins after the agreement is made. To apply the obligating events approach, four points are considered as potential recognition events:
  - Grant agreement is entered into and the resources are provided
  - Once the specified fiscal year(s) begins

- As the performance obligation is satisfied
- Once performance obligation is fully satisfied.

### **Appropriation**

23. The timing of an appropriation may affect recognition in the case of non-exchange transactions with a performance obligation. Timing of the appropriation can affect those transactions in two ways. First, entities may incur eligible costs for an activity (thus meeting the performance obligation) in advance of the appropriation being approved that is intended to provide resources for that activity. Although this may occur in transactions both with and without performance obligations, the next section of this appendix discusses that situation for transactions without performance obligations. The first case (transactions with performance obligations) is addressed here. The appropriation may be approved on a specific date, but have an effective date in the future.
24. Some may argue that once the performance obligation is satisfied, the public sector entities could recognize the transaction on the date the appropriation is approved or the date on which the appropriation becomes effective.
25. At the date of approval, the public sector entity providing resources conceivably has an option to avoid the outflow by modifying the appropriation before the effective date. Moreover, the appropriation is not legally enforceable until the effective date. Once the appropriation is approved, some would argue that if the other requirements, or performance obligations, have been met, the provider has an obligation to the recipients. The recipients may argue that the performance obligation has been met and the appropriation has been approved; therefore, the public sector entity providing resources can no longer avoid the transfer of resources. The public sector entity providing resources would need to take specific action to change the appropriation after approval. Using this argument, the recipient recognizes revenue and the provider recognizes expense, provided the performance obligation has been satisfied.
26. Although the appropriation has been approved, it was approved with an effective date in the future. Some argue that the appropriation is subject to change and is not legally enforceable until the effective date, and therefore, uncertainty exists, until the effective date. Until the effective date, the public sector entity providing resources could modify the appropriation. Those who make this argument believe that even though the performance obligation has been met, the public sector entity providing resources has a realistic alternative to avoid the outflow.
27. For non-exchange transactions, some argue that the public sector entity providing resources is not contractually bound to provide resources to the recipient. The appropriation can be changed, revoked, or otherwise eliminated at any point prior to the effective date. Proponents of this argument also believe that the recipient does not have a legal right to those resources and therefore cannot control resources until the effective date of the appropriation. The obligating event under this approach would be the effective date of the appropriation, or the satisfaction of the performance obligation, whichever is later.

### **No Performance Obligations With Additional Factors**

28. Non-exchange transactions between public sector entities may not have performance obligations, but still have additional factors described above that may affect recognition. As discussed in this memo, the term “performance obligation” may need further exploration. For purposes of the examples

presented in this appendix, general obligations of the recipient, such as the responsibility to remain in operation, are not considered to be performance obligations. This type of transaction is presented in Examples 5 and 6.

### **Eligibility Requirement**

29. A non-exchange transaction without a performance obligation may have an eligibility requirement. An eligibility requirement for grants may be imposed at the time that a potential recipient applies for the grant. The grant may not be made if the eligibility requirement is not met. The eligibility requirement also may be an on-going requirement.
30. With no performance obligation on which to consider basing recognition, the public sector entities may consider whether the satisfaction of the eligibility requirement gives rise to a present obligation. The eligibility requirement may be satisfied at the time of initial agreement or throughout the agreement.
31. Eligibility requirements are often a pre-requisite to obtaining grants or other funding. One could argue that if the eligibility criteria are met at the time of agreement, the recipient has claim to resources of the provider. The provider has little to no alternative to avoid the outflow. Some may argue the transaction may be recognized at this point.
32. Some grants or other agreements may indicate that funding is provided only if the recipient continues to satisfy eligibility requirements. Some would argue that the recipient must meet the eligibility requirement throughout the agreement to gain control of the resources. Those who make this argument believe that the provider has the alternative to avoid the outflows any time the recipient does not meet the eligibility requirement.

### **Timing Restriction**

33. Time requirements associated with a grant agreement also may affect the recognition of non-exchange transactions without performance obligations. The timing restriction is the requirement for the recipient to use the funds for the fiscal year that begins after the resources have been provided. To apply the obligating events approach, two points considered as potential obligating events are when the resources are provided and once the specified fiscal year begins. Recognition should consider the point at which the recipient controls resources of the provider and when the provider can no longer avoid the obligation.

### **Appropriation**

34. The timing of events surrounding an appropriation of resources by the public sector entity providing resources was discussed previously in the context of non-exchange transactions with a performance obligation. The timing of the appropriation also may be important to non-exchange transactions without a performance obligation.
35. The recipient has no performance obligation to satisfy and no other factors to consider other than the appropriation. Recognition may occur at the approval date or at the effective date of the appropriation.
36. Once the appropriation is approved, some would argue that if there are no other requirements, including performance obligations, the recipient is not required to take any further action to gain control of the resources and the provider has a constructive obligation to the recipient. The recipient may argue that the public sector entity providing resources can no longer realistically avoid the

outflow once the appropriation has been approved. The public sector entity would need to take specific action to change the appropriation after approval. Using this argument, the recipient recognizes revenue at the time of the approval, which is also the time of resource flow in this example. Conflict may arise if the public sector entity providing resources does not recognize the related liability at the time the appropriation is approved.

37. Although the appropriation has been approved, it was approved with an effective date in the future, or on the date of the beginning of the recipient's fiscal year. Some may argue that the provider has no legal obligation to provide resources until the appropriation becomes effective. The appropriation can be changed, revoked, or otherwise eliminated at any point prior to the effective date. Proponents of this argument also believe that the recipient does not yet control resources. Proponents of this argument believe the obligating event under this approach is the effective date of the appropriation, or the beginning of the fiscal year specified.

### **No Performance Obligations With No Additional Factors**

38. The last type of transaction to consider are transfers of resources in a non-exchange transaction where there are no performance obligations and no additional factors. For example, a public sector entity transfers funds to another public sector entity for immediate use in any manner determined by the public sector entity receiving the funds. Recognition cannot be based on performance obligations that do not exist. As there are no other criteria to satisfy for the use of the funds (eligibility requirements, timing requirements, appropriations) the transfer of funds could be recognized at the time of the agreement or at the time of payment. This type of transaction is presented in Examples 7 and 8.
39. Some non-exchange transactions with no performance obligations and no additional factors are made based on agreements between the public sector entities, such as the forgiveness of a loan in Example 8. The forgiveness of the loan could represent the agreement between the entities. Once the agreement is reached, the provider public sector entity likely has little to no alternative to avoid the outflow of resources through the forgiveness of debt. The agreement likely creates a valid expectation by the recipient. The agreement could be considered to be an obligating event and could trigger recognition.
40. Often, non-exchange transactions without performance obligations or additional factors are made without an agreement, either formal or informal. For example, a central government makes a transfer to the sub-national entities during a severe recession to stimulate the economy without a specific agreement. Resources are transferred to the local governments' accounts and the national government does not specify any particular use of the funds. In this case, the only indicator of a possible transaction is the actual payment of funds. With no other trigger to recognition, the transaction could be recorded at the time of the flow of resources.

<b>Example 1</b>	<b>Performance Obligation with No Additional Factors</b> <b>Vaccination grant</b> Grant from a central government to a local government health department to subsidize a portion of a vaccination program for residents of the community.
Specifications (Quantity, quality, location, timing of services)	500 vaccinations. Health industry guidelines regarding use of approved vaccines and safe storage and protocols for administering vaccines must be complied with. “Residents of the community” implies a geographic area. No time restriction on when the vaccinations must be completed.
Cost	The funding provider will pay 50 percent of the actual costs for 500 vaccinations, up to a specific amount for each vaccination. The resources to be provided are based on the actual number of vaccinations provided.
Timing of payment	Variation 1: The subsidy will be paid once 500 vaccinations are provided. Variation 2: The subsidy will be paid on a pro rata basis, based on the actual number of vaccinations provided at the end of each month.
Availability of funds	The public sector entity providing resources has authority to spend the funds.
Eligibility criteria	No specific criteria over and above the specifications set out above.

<b>Example 2</b>	<b>Performance Obligation with Additional Factor (Eligibility Requirement)</b> <b>Mental health services</b> Grant from a central government to a local government to provide mental health services at a prison.
Specifications (Quantity, quality, location, timing of services)	No minimum quantity specified. Provide as many services as possible– up to the maximum amount of the grant. The service provider must be an accredited mental health provider and comply with industry codes of ethics. At a specific prison. No specific timing for services.
Cost	The funding provider will pay for 25 percent of the costs to provide services, up to a maximum amount.
Timing of payment	Variation 1: the grant will be paid once the service provider has provided all the services up to the maximum amount of the grant. Variation 2: the subsidy will be paid on a pro rata basis, based on the actual services provided at the end of each month.
Availability of funds	Authorization of funding is expected.

<b>Example 2</b>	<p><b>Performance Obligation with Additional Factor (Eligibility Requirement)</b></p> <p><b>Mental health services</b></p> <p>Grant from a central government to a local government to provide mental health services at a prison.</p>
Eligibility criteria	<p>The service provider must be accredited with a specific accrediting agency.</p> <p>Variation 1: The service provider must be accredited at the beginning of the agreement.</p> <p>Variation 2: The service provider must be accredited throughout the duration of the agreement.</p>

<b>Example 3</b>	<p><b>Performance Obligation with Additional Factor (Timing Restriction)</b></p> <p><b>Dental services</b></p> <p>Grant from a central government to a local government health department to provide dental services to low-income families.</p>
Specifications (Quantity, quality, location, timing of services)	<p>Quantity not specified.</p> <p>Industry guidelines are expected to be followed.</p> <p>Location not specified.</p> <p>The dental services are to be provided from 1 July onwards, which is the beginning of the recipient's fiscal year.</p>
Cost	<p>The funding provider will pay for 50 percent of the costs to provide services, up to a maximum amount.</p>
Timing of payment (or return of payment)	<p>The funding provider transfers the expected amount of the grant to the service provider as soon as the grant agreement is signed, on 15 June.</p> <p>The funding provider can demand a full refund if the resources are spent before 1 July or a partial refund (on a pro rata basis) at any time up until the dental services have been provided.</p>
Availability of funds	<p>The resource provider has access to authorized funds.</p>

<b>Example 4</b>	<p><b>Performance Obligation with Additional Factor (Appropriation)</b></p> <p><b>Funding road construction</b></p> <p>Central government reimburses subnational government for the cost of constructing roads.</p>
Specifications	To be specified in each approved project.
Cost	Expected cost and maximum amount to be reimbursed to be specified in each approved project.
Timing of payment	Legislation specifies that payment will be made when the project is complete, subject to authorized funds being available.
Availability of funds	<p>Legislation requires an annual appropriation to cover the expected costs. The appropriation becomes effective at the beginning of the fiscal year. The resources for the program are provided by a petrol tax. In the past there has been a history of the petrol taxes collected not being sufficient to cover the construction projects that have been approved.</p> <p>Appropriation approved 1 June.</p> <p>Effective date of appropriation 1 July.</p> <p>The appropriation can be changed or revoked at any time prior to 1 July.</p>

<b>Example 5</b>	<p><b>No Performance Obligation with Additional Factor (Eligibility Requirement)</b></p> <p><b>Low income transfer</b></p> <p>Central government provides funding to local jurisdiction based on the average income of the residents in the jurisdiction.</p>
Specifications	Not applicable
Cost	CU100,000
Timing of payment	At the end of each quarter for the preceding quarter.
Availability of funds	Authorized funds are available.
Eligibility requirements	<p>Variation 1: Residents of the local jurisdiction must have an average income under the specified level as at 1 July.</p> <p>Variation 2: Residents of the local jurisdiction must have an average income under the specified level as at the end of each quarter.</p>

<b>Example 6</b>	<b>No Performance Obligation with Additional Factor (Timing Restriction) Funding of Public Sector University</b> Central government agrees to provide general funding to a public sector university.
Specifications	Not applicable
Cost	CU100,000
Timing of payment	Five payments of CU20,000 over the year. Delayed payment or non-payment could occur due to central government overspending in other areas.
Availability of funds	An annual appropriation is required. Appropriations are approved on 1 June and effective from 1 July.
Eligibility requirements	Not applicable.

Variation: Government agrees to provide funding for two years.

<b>Example 7</b>	<b>No Performance Obligation with No Additional Factors Grant with no requirements</b> Public sector entity transfers funds to another public sector entity for immediate use in any manner by the recipient.
Specifications	Not applicable
Cost	CU100,000
Timing of payment	Payable at the beginning of the year.
Availability of funds	Assume that amount transferred was appropriately authorized by an appropriation.
Eligibility requirements	Not applicable.

<b>Example 8</b>	<b>No Performance Obligation with No Additional Factors</b> <b>Forgiveness of loan</b> Public sector entity forgives the remaining amount owed to it by another public sector entity.
Specifications	Not applicable
Cost	CU50,000
Timing of payment	No cash flow. The decision to forgive the balance of the loan is made at the end of January and communicated to the entity owing the funds in February.
Availability of funds	Assume that the expense for the amount forgiven was appropriately authorized by an appropriation.
Eligibility requirements	Not applicable.

### Research Agreements

Sponsored Research Agreements generally include terms governing the following:

- Scope of work to be conducted
- Budget for the research
- Payment obligations and timing
- Management and staffing of the research project
- Schedules and deliverables
- Publication of the research results
- Options to license the intellectual property arising from the research
- Care of data and confidential information exchanged during the research
- Transfer of materials (when needed)
- Compliance with laws and regulations
- Rights and procedures to terminate the project
- Taxes, insurance, warranties, liability, governing law, and other items necessary for contracts/binding agreements

The following two research examples focus on aspects of sponsored research agreements that are considered to be the most relevant for illustrating the accounting issues.

<p><b>Example 9</b></p>	<p><b>Performance Obligations With Additional Factor (Eligibility Requirement)</b></p> <p><b>Research agreement: Health</b></p> <p>A government gives money to a university for research into the most effective way of helping people to stop smoking.</p>
<p>Specifications (Quantity, quality, location, timing of services)</p>	<p>The project will result in a research report.</p> <p>Key milestones include: completion of literature review, collection of data and completion of the report.</p> <p>The research agreement will specify how the project will be carried out (for example, the role of the Project Leader, other university employees and students).</p> <p>The project is subject to certain codes of ethics and requires approval from an ethics committee.</p> <p>The research will be conducted at the University, using the University's facilities.</p> <p>The agreement commences on the effective date and terminates at the completion of the project.</p>
<p>Cost</p>	<p>CU100,000</p> <p>Details of the funds spent must be provided, and, if there is any unspent funds, they must be repaid to the Government at the end of the research.</p>
<p>Timing of payment</p>	<p>There are to be three payments:</p> <p>50% of the total within 10 working days of signing the agreement</p> <p>40% of the total on satisfactory completion of data collection.</p> <p>10% of the total on satisfactory receipt of the final report.</p>
<p>Availability of funds</p>	<p>The Government has authorized funds available.</p>
<p>Other</p>	<p>The university has the right to publish the results of the research.</p> <p>The Government has the right to use the research findings in developing its policies and can make the findings available to others.</p> <p>The Government can cancel the agreement immediately if the University is in serious breach of the agreement.</p>

Variation 1: The Government will fund the actual project costs, up to a maximum of CU100,000. The University will invoice the Government quarterly.

<p><b>Example 10</b></p>	<p><b>Performance Obligations with Additional Factor (Timing Requirement)</b>  <b>Research agreement: Science</b>                  A government agrees to fund a five year project to develop ground motion prediction models for global shallow crustal earthquakes.</p>
<p>Specifications                  (Quantity, quality, location, timing of services)</p>	<p>An annual report on progress is required at the end of each year.                  The research agreement will specify how the project will be carried out (for example, the role of the Project Leader, other university employees and students).                  The research will be conducted at the University, using the University's facilities.                  The agreement commences on the effective date and terminates at the completion of the project.</p>
<p>Cost</p>	<p>CU500,000</p>
<p>Timing of payment</p>	<p>100,000 is to be provided at the beginning of each year.                  The university does not have to refund any unspent money.</p>
<p>Availability of funds</p>	<p>The funds for the project have to be appropriated each year.</p>
<p>Other</p>	<p>The university has the right to publish the results of the research.</p>

**ISSUES PAPER, NON-EXCHANGE EXPENSES****Objectives of this Paper**

1. This Issues Paper continues to explore the boundaries of the non-exchange expenses project by evaluating the distinction between exchange and non-exchange transactions. The paper also explores the distinction between non-exchange transactions that are within the scope of the non-exchange expenses project and those included in the social benefits project.

**Background**

2. Public sector entities provide resources through non-exchange transactions with a variety of entities. Some of these transactions are clearly non-exchange, while other are not as easily classified. In June, a separate Issues Paper explored views at different ends of a spectrum that could be used to classify public sector transactions as exchange or non-exchange. At one end of the spectrum, one could argue that all or nearly all transactions of a public sector entity are fundamentally non-exchange because the public sector entity does not engage in activities for its direct benefit. At the other end of the spectrum, one could argue that all public sector entity transactions with any degree of performance obligations are exchange transactions.
3. At the June meeting it was posited that public sector transactions often include two parts, an exchange component and a non-exchange component. While the project staff believe that this approach is theoretically sound, the non-exchange component of the transaction generally is not reflected in the financial statements and may or may not be used in practice to ultimately classify the first component of the transaction in the financial statements.

**Current Definition**

4. As noted during the June meeting, the current definition of non-exchange transactions is found in IPSAS 9, *Revenue from Exchange Transactions*, paragraph 11, as follows:

Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly receiving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

5. Through the discussions to date, several challenges in operationalizing the definition above were identified. Transactions in the public sector often have unique characteristics that may make classification difficult. Judgement is often needed. To consider potential clarifications that would assist in operationalizing the definition of a non-exchange transaction, several characteristics are considered in the following section:
  - Value exchanged
  - Presence of a performance obligation
  - Presence of stipulations on the use of the transferred resource, including timing requirements
  - Degree of control on use of resources

- Type of recipient
- Presence of eligibility requirements

#### **Matter(s) for Consideration**

1. The IPSASB is asked to identify any further characteristics that should be analyzed in considering operationalizing the definition of a non-exchange transaction.

## **Characteristics**

### **Value Exchanged**

6. Throughout the discussions in prior meetings, as well as the review of literature and other standards presented in June, a central idea to the definition of non-exchange transactions is that the value exchanged is not equal. Most definitions of non-exchange transactions include a provision or statement that the value exchanged is not equal or not reciprocal.
7. Public sector transactions often involve the delivery of goods or services for which the value is difficult to determine. To illustrate this issue, an example similar to one found in agenda item 7.1 is used. In this example, a public sector entity provides a grant to a not-for-profit entity to subsidize the costs of vaccinations. The grant will pay for 50 percent of the actual costs of 500 vaccinations, up to a specified amount for each vaccination. In this example, the public sector entity gives value to the not-for-profit that can be quantified by the amount of funding of the actual costs; however, that cost is capped. The public sector entity is reimbursing the not-for-profit entity for services provided, but only up to a specified amount. The question is—who is the recipient of that value? The public sector entity, its residents, the community at large, or all of these parties?
8. The value of the reimbursement can be easily measured; however, the value of an increased number of residents vaccinated cannot be easily measured. In addition, while the public sector entity is providing resources, the value generated from those resources does not exclusively flow to the public sector entity.
9. As noted above, public sector entities generally engage in transactions that do not generate value directly or exclusively to the entity itself. The provision of collective goods and services or universal health care and education, while improving the quality of life within the public sector's jurisdiction, does not generate value to the entity itself. However, these types of goods and services often involve the two-part transactions described in the June Issues Paper. For example, to provide education to its constituents, the public sector entity enters into a contract with a teacher. The contract gives the public sector entity the right to the teacher's services, which it in turn uses for the benefit of the public sector entity's constituents. The first part of the transaction could be viewed as exchange in nature, while the second could be viewed as non-exchange.
10. It is interesting to note that the entity that a public sector entity contracts with often influences how the transaction is classified in practice. For example, if a public sector entity contracts for services with a private sector entity there is often a presumption in practice that the execution of the contract results in a transactions where approximately equal values are exchanged; however, if the same contract is executed with a not-for-profit entity or another public entity, there is often a presumption in practice that the execution of the contract may not be approximately equal. The type of receipt is further explored later in this paper. The goal of this project is not to redefine non-exchange

transactions; therefore, the value exchanged (no matter how difficult to determine) will continue to be an integral part of the non-exchange transaction definition.

**Matter(s) for Consideration**

2. The IPSASB is asked to affirm that the value exchanged will continue to be an integral part of the non-exchange transaction definition.

**Performance Obligations**

11. As discussed in the agenda item 7.1, the term performance obligation may need additional clarifications for use in the public sector. Performance obligations are defined in International Financial Reporting Standard 15, *Revenue from Contracts with Customers*, as promises in a contract to transfer to a customer goods or services that are distinct. Clarifications to the IASB definition may be necessary to more closely align it with transactions found in the public sector - for example, to reflect that the delivery of goods or services to or on behalf of a public sector entity may be a performance obligation.
12. Transactions in the public sector also may be subject to restrictions, conditions, eligibility requirements, or other factors that are generally not present in transactions outside the public sector. Some may consider these additional factors to be performance obligations, while others may not. Clarifications associated with the definition of a performance obligation will be the subject of future papers. Therefore, whether the presence or absence of performance obligations indicates that a transaction is non-exchange in nature will be addressed at that time.
13. Depending on the arrangement, the performance obligation can be a significant or a de minimis characteristic. Moreover, the performance obligation may or may not be directly related to the value exchanged.

**Matter(s) for Consideration**

3. The IPSASB is asked to consider if it agrees that transactions with performance obligations should be considered as a possible clarifying characteristic at a later date.

**Stipulations**

14. Stipulations have been defined in current IPSASB literature as *terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity*.<sup>1</sup> Stipulations are often associated with non-exchange transactions and may be either conditions or restrictions. Conditions are stipulations that specify that resources be used in a particular manner, and if the resources are not used as specified, the resources must be returned. Restrictions limit or direct the purpose of the transferred asset, but do not require that the resources be returned if the resources are not used as specified. As the definition of a performance obligation is further developed for the public sector some overlaps of performance obligations and stipulations likely are to be identified. Therefore, the application of stipulations as a potential clarifying characteristic will be further considered in conjunction with performance obligations.

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<sup>1</sup> IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

## **Degree of Control**

15. Similar to the concept of stipulations is the idea of the degree of control that a public sector entity transferring resources may retain over the resources transferred. Certain public sector transactions allow the entity transferring resources to retain more control over the resources transferred than others. Again, this potential clarifying characteristic is closely tied to performance obligations. Therefore, the application of the degree of control as a potential clarifying characteristic will be further considered in conjunction with performance obligations.

## **Type of Recipient**

16. As previously noted, public sector entities enter into transactions, both exchange and non-exchange, with a variety of recipients. Recipients may be for-profit entities, not-for profit organizations, other public sector entities, or individuals. The potential effects of the type of entity on the recognition of non-exchange transactions and will be discussed at a later meeting.
17. The discussion in this paper centers on the issue of whether the type of recipient is essential to identifying whether a transaction is an exchange or non-exchange transaction. The following examples explore this issue.
18. In our first example, consider a central government that provides research funding to a private, for-profit laboratory. The central government specifies in the contract that the research results are to be shared with the central government before being announced to the public and that the central government has the right to apply for any patents that might result from the research.
19. The central government provides resources in the form of the funding to the private, for-profit laboratory. The for-profit laboratory provides the research results and patent rights in return. As previously noted, in practice there has been a presumption that the value of the resources provided is approximately equal to the value of the research results and patent rights, so the transaction is an exchange transaction. However, this practical expedient may not always be true. For example, a private sector entity may be subsidizing a transaction with the expectation of obtain additional contracts where larger profits can be obtained.
20. On the other hand, in some countries it is illegal for the public sector to subsidize the private sector; therefore, in those countries there may be a presumption that the transaction is not (at least in part) a subsidy to the private sector. However, as noted in an example presented below, compliance with these laws are not strictly enforced (especially in cases involving economic development).
21. If the same resources are provided by the central government through a grant with a laboratory at a public university, the result currently found in practice could be the same or quite different. In this example, the central government specifies in the grant that the research results are to be shared with the central government before being announced to the public and that the central government has the right to apply for any patents that might result from the research.
22. In this example, the central government is providing resources to the public university in the form of a grant and is receiving research results and patents rights in return. From the perspective of the grant recipient, the public university, the university is receiving the grant funds and giving the results and patent rights. However, as previously noted when dealing with a public sector transaction, the presumption that the values exchanged are approximately equal may not always be the case. Because it is a grant, the central government may have no expectation that the research results and patent rights will be equal to resources provided.

23. A contract or a grant with similar features entered into with the private sector, another public sector entity, or a not-for-profit entity may have other motivations that should be explored. However, when the values that are exchanged are determined to be approximately equal, the sector receiving the resources should not matter.

*For-profit entities*

24. For profit entities generally exist to provide return on investment to owners. Public sector entities are often customers of for-profit entities and pay the for-profit entities in exchange for goods or services. Exchange transactions between a public sector entity as a resource provider and a for-profit entity are therefore common.
25. Given the motive of for-profit entities to generate returns, would a public sector entity ever provide resources to a for-profit entity without receiving approximately equal value in return? Consider the following example. A for-profit land development company is considering a project to purchase and rehabilitate a building in a local government's downtown district. The cost of the project is estimated at approximately CU10 million. The local government supports the rehabilitation efforts in order to increase the property values, increase tax revenues and improve the quality of life for its residents. To encourage the project, the local government agrees to provide a portion of the funding for the project through a grant of CU3 million. The funds are not a loan and will not be repaid.
26. The local government has provided resources to the for-profit development company. While the local government will benefit from increased property values that will increase property tax revenues, the local government does not receive an interest in the project or the development company. While property taxes will increase, it is unlikely that they will increase in an amount approximately equal to the grant provided in the initial year after completion. Therefore, the local government, or its constituents, do not directly receive value for the grant funds provided and this transaction likely does not meet the definition of an exchange transaction.
27. With these examples, it is clear that public sector entities may engage in both exchange and non-exchange transactions with for-profit entities.

*Not-for-profit entities*

28. As described in several examples above, public sector entities enter into many transactions with not-for-profit entities, primarily described as grants. Not-for-profit entities may rely on this grant funding for a significant portion of revenues. Not-for-profit entities exist to fulfill the mission of the organization, not to generate a profit. As not-for-profit entities do not exist to generate a profit, would all transactions between a not-for-profit and a public sector entity be non-exchange transactions?
29. In one example described above, a public sector entity provides a grant to a not for profit entity to pay 50% of the costs incurred to administer 500 vaccinations within the community, up to a specified amount per vaccination. Because the value provided by the public sector entity only pays half of the costs incurred, up to a maximum amount per vaccination, the value received by the not-for-profit is not approximately equal to the value given up by the not-for-profit. Whether the transaction is a non-exchange transaction often is a subject of debate.
30. A public sector entity may also enter into a contract for similar services with a not-for-profit entity that provides the same type of health care services. Using the same type of services, in this example, the public sector entity enters into a contract with a not-for-profit entity to provide flu shots to its

constituents and agrees to pay a specific rate for each vaccination. The rate is determined by the not-for-profit and is the same rate that the not-for-profit charges to private insurance companies, corporate employers, and individuals seeking vaccination.

31. In this situation, if the value exchanged is approximately equal, in practice this transaction likely is classified as an exchange transaction. However, it should again be noted that the government does not receive the benefit of the service (the citizens receive the benefit).

#### *Public sector entities*

32. Many examples of non-exchange transactions between public sector entities have been discussed, both in this paper and in the separate overlap paper (agenda item 7.1). Many transactions between public sector entities are non-exchange, including the grant of general budgetary support from one public sector entity to another that does not require any particular use of the funds or delivery of a good or service. However, as previously noted, public sector entities also may potentially engage in exchange transactions with other public sector entities.

#### *Individuals and households*

33. Public sector entities also transfer resources to individuals and households. These transactions may be exchange or non-exchange.
34. A common exchange transaction between a public sector entity and an individual exists in the form of an employment relationship. When a public sector entity employs a school teacher and pays the teacher a salary, the public sector entity acquires and controls the right to use the teacher's services, representing an exchange transaction. As discussed in previous papers, the public sector entity does not directly benefit from the teacher's services. While the theoretical approach to this transaction would be to recognize the right to use asset in the exchange transaction, followed by a non-exchange expense to use those services for the benefit of the public, the practical expedient currently used in practice is that the entire transaction is recognized as an exchange transaction.
35. A public sector entity also may enter into non-exchange transactions, both those that are in the scope of this of the project, and those that are social benefits. The distinction between social benefits and other transfers in kind is discussed later in this paper.

#### **Eligibility Requirements**

36. Eligibility requirements can take several forms, but often refer to required characteristics of recipients that must be met before a recipient can receive funds from a public sector entity. Public sector entities may require that recipients be a certain type of entity, possess certain qualifications, meet age or income requirements, or live in a specified area. Public sector entities also may require that eligible costs be incurred prior to transfer of funds, or that costs be incurred in a specified time frame. Eligibility requirements also may take the form of a contingency – that is, resources will be provided if a specified event takes place. These events may be within the control of the recipient, such as raising matching funds, or out of the recipient's control, such as a natural disaster.
37. Eligibility requirements are often present in non-exchange transactions. Recipients of a non-exchange transaction may have to meet income levels, or demonstrate need to qualify for benefits, especially social benefits. Eligibility requirements are not necessarily unique to social benefits as they can be present in other non-exchange transactions as well.

38. For example, to encourage environmental conservation efforts, a local government has a program in which land owners in a specified area may be paid a subsidy to not farm or plant crops on land in the specified area. Each year the land in the specified area is not farmed, the land owner is paid a designated amount per acre by the local government.
39. The local government and its constituents do not receive value in exchange for the subsidy paid to the land owner; therefore, this is a non-exchange transaction. The land owners must satisfy eligibility requirements to receive payment. The land must first be in a specified area. The land also must be left idle, or not farmed, in order to qualify for payment to the land owner.
40. Eligibility requirements also may be present in exchange transactions. For example, a public sector entity may advertise for contractors to submit bids to build a prison for the public sector entity. The contractors must be licensed in order to submit a bid and provide the construction goods and services. The public sector entity will transfer resources in exchange for the goods and services to build the prison structure, but only to eligible contractors. Therefore, eligibility requirements may exist for both non-exchange and exchange transactions.

**Matter(s) for Consideration**

4. The IPSASB is asked to consider which of the characteristics above, if any, should be further considered in operationalizing to the definition of non-exchange transactions.

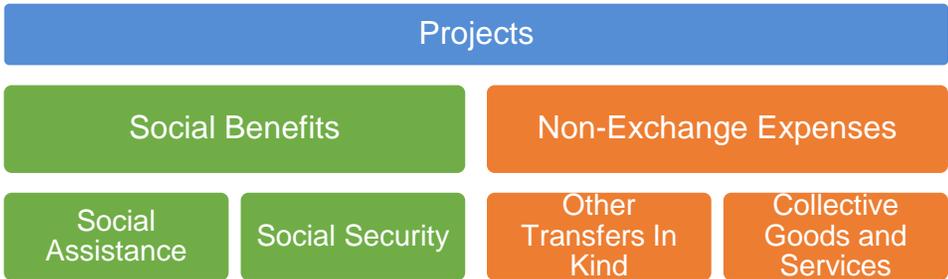
**Social Benefits**

41. Social benefits have been defined in the social benefits Consultation Paper (CP) as benefits payable to individuals and households, in cash or in kind, to mitigate the effect of social risks. Social risks are defined in the CP as events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income.
42. The social benefits CP specifically excludes goods and services to individuals and households for reasons other than to protect against social risks, such as universal health and education services. The social benefits CP also specifically excludes collective goods and services, such as defense and public order, as these goods and services are deemed to be public goods and services, as opposed to private goods and services.
43. The social benefits CP intends to align the definition of social benefits with the provisions of Government Finance Statistics Manual (GFSM). With this intention in mind, this section considers which transactions with individuals or households will be within the scope of this non-exchange expenses project.
44. Certain resources provided to individuals and households as social benefits can be easily identified. These transactions include social security and social assistance benefits. Social security benefits are payable in cash or in kind due to old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, or health care. There is not necessarily a direct link between the amount contributed by an individual and the benefits receivable. Social assistance schemes provide similar assistance to persons in need without any requirement to participate through the payment of contributions.
45. In addition to collective goods and services, the GFSM indicates that there are additional types of transactions which are not considered to be social benefits. Subsidies are described as current unrequited transfers that government units make to enterprises on the basis of the level of their

production activities or the quantities or values of the goods or services they produce, sell, export, or import.<sup>2</sup> Subsidies may be designed to influence levels of productions, prices of outputs, or profits of enterprises. Because these subsidies do not mitigate social risks, they are not considered to be social benefits.

- 46. The GFSM also indicates that transfers made in response to unusual events are not considered social benefits. Transfers made for the types of events or circumstances that are normally covered by the scheme, such as old age, injury, illness, etc., are considered social benefits. Transfers made in response unusual events, such as natural disasters or destruction during wars, should be recorded as transfers not elsewhere classified, not social benefits.<sup>3</sup>
- 47. Given the IPSASB’s proposal to align the definition of social benefits with the GFSM definitions, the descriptions above should be considered in evaluating examples of transactions with individuals and households to determine the scope of the non-exchange expenses project.
- 48. The social benefits CP identified three specific examples of the types of schemes that would need to be addressed by the recognition models considered in that document: retirement benefits, unemployment benefits, and injury benefits. The social benefits CP indicates that these three schemes are not the only types that would be in the scope; rather, these types represent a very small sample of the types of transactions that are considered to be social benefits.
- 49. The following graphic demonstrates the project boundaries described by the social benefits project.

**Diagram 2 – Link to Social Benefits**



<sup>2</sup> Government Finance Statistics Manual (GFSM), 6.84.

<sup>3</sup> GFSM, A2.10.

50. Consistent with the definitions in GFSM, the following types of transactions would not be considered social benefits, but within the scope of this project:
- (a) Collective goods and services
    - (i) Defense
    - (ii) Public order
  - (b) Other transfers in kind
    - (i) Universal education
    - (ii) Universal health
  - (c) Subsidies
  - (d) Transfers to individuals or households in response to events or circumstances that are not normally covered by social insurance schemes
    - (i) Natural disasters
    - (ii) Destruction during wars.

**Matter(s) for Consideration**

5. The IPSASB is asked to identify any other transactions that should be considered for inclusion within the scope of the non-exchange expenses project.