

**Meeting:** International Public Sector Accounting Standards Board  
**Meeting Location:** Toronto, Canada  
**Meeting Date:** June 21-24, 2016

**Agenda  
Item  
11**

For:  
 Approval  
 Discussion  
 Information

***Revenue and Non-Exchange Expenses***

**Objectives of Agenda Item**

1. The overall objective of this item is to seek feedback from the IPSASB to assist in drafting several chapters of the Consultation Paper for revenue and non-exchange expenses. Specifically, staff are seeking feedback regarding the scope of the consultation paper, application of the performance obligation approach to expense transactions, statutory receivables, and modifications to existing guidance as alternatives for non-exchange expenses.
2. Staff are also seeking feedback on the preliminary outline of the Consultation Paper and the drafts of Chapter 1, Chapter 2, and Appendices A-D.
3. Agenda Item 11.6 is presented for discussion purposes.

**Materials Presented**

- Agenda Item 11.1 Consultation Paper Draft Outline
- Agenda Item 11.2 Issues Paper – Consultation Paper Scope
- Agenda Item 11.3 Consultation Paper – Chapter 1
- Agenda Item 11.4 Issues Paper – Non-Exchange Expenses, Application of Performance Obligation Model to Expense Transactions
- Agenda Item 11.5 Consultation Paper – Chapter 2
- Agenda Item 11.5.1 Issues Paper – Performance Obligation Approach, Discussion of Revenue Examples
- Agenda Item 11.6 Issues Paper – Other Resources and Other Obligations
- Agenda Item 11.7 Issues Paper – IPSAS 23 Direction for September Meeting
- Agenda Item 11.8 Issues Paper – Revenue, Statutory Receivables
- Agenda Item 11.9 Issues Paper – Non-Exchange Expenses, Modifications to Existing Guidance as Alternatives
- Agenda Item 11.10 Consultation Paper – Appendices A-D

**Action Requested**

1. The IPSASB is asked to provide feedback on the Matters for Consideration in Agenda Papers 11.2, 11.4, 11.5.1, 11.7, 11.8 and 11.9.
2. The IPSASB is asked to provide feedback on the drafts of Chapter 1 and Appendices A and B of the Consultation Paper.
3. The IPSASB is asked to provide feedback and direction on Chapters 2 and 3 of the Consultation Paper.
4. The IPSASB is asked to provide feedback and direction on Appendix C and Appendix D of the Consultation Paper.

## Revenue and Expenses Consultation Paper Outline

### Chapter 1: Introduction

*Issues Paper – Consultation Paper Scope (Agenda Item 11.2)*

*Consultation Paper Draft Chapter Complete (Agenda Item 11.3)*

- Introductory comments
- Project Objectives (high level)
- Current Environment
  - Implementation issues with IPSAS 23 and IPSAS 19

*Feedback from preparers is described with brief summary of major issues raised (classifying transactions as exchange or non-exchange, concerns related to timing issues arising from accounting for restrictions and conditions in IPSAS 23, recognition of non-exchange expenses under IPSAS 19).*

- New private sector revenue recognition model

*Core principle of IFRS 15 is described.*

*IFRS 15 is described as key reference point for performance obligation model in later chapter.*

*Does NOT include detailed description of IFRS 15 (will be included in Chapter 2).*

- Conceptual Framework

*Discuss importance of information about revenues and expenses.*

*Describe recognition and measurement in a broad sense with reference to further discussion in later chapters.*

- History and scope of the projects

*Brief mention of current guidance with reference to Appendix.*

*Describes journey of the two projects and why they are being presented in one CP.*

*Scope of revenue and expense transactions included in the project.*

- Interaction with other projects and pronouncements
  - Approach of this CP

*Describe chapters to follow*

*Address repetition and referencing*

## **Chapter 2: Performance Obligation Approach**

***Issues Paper – Application of Performance Obligation Approach to Expenses (Agenda Item 11.4)***

***Consultation Paper Draft Chapter Partially Complete (Agenda Item 11.5)***

***Issues Paper – Performance Obligation Approach Discussion of Revenue Examples (Agenda Item 11.5.1)***

***Issues Paper – Other Resources and Other Obligations (Agenda Item 11.6)***

***Issues Paper – IPSAS 23 Directions for September (Agenda Item 11.7)***

- Overview of model
- Overview of IFRS 15 performance obligation model
- Potential application to public sector transactions
  - Category A – Revenue and expense transactions that would fall within the scope of an IPSAS based on a pure IFRS 15 performance obligation approach
  - Category B – Revenue and expense transactions which have some form of performance obligation, but which do not contain all the key characteristics of a transaction within the scope of the IFRS 15 model
  - Category C – Revenue and expense transactions with no performance obligations (model would not apply, need for residual standard)
    - Application to revenue transactions
- Category A
  - IPSAS Standard Converged with IFRS 15
- Category B
  - Modifications to IFRS performance obligation approach to capture a wider scope of public sector transactions
- Category C (*See Separate Presentation*)
  - Modifications to IPSAS 23
    - Restrictions
    - Appropriation and form of government
      - Application to expense transactions
- Category B
  - Modifications to IFRS performance obligation approach to capture expense transactions
- Category C
  - Modifications to IPSAS 23
  - Modifications to IPSAS 19
    - Advantages and disadvantages of overall approach

## **Agenda Items**

### ***Issues Paper – Statutory Receivables (Agenda Item 11.8)***

### **Chapter 3: Exchange/Non-Exchange Classification Approach**

***Issues Paper – Modifications to Existing Guidance as Alternatives (Agenda Item 11.9)***  
***Discussion of Outline Below***

- Overview of model
  - Current definitions of exchange and non-exchange
  - Revenue alternatives presented
    - Two options for exchange revenues
    - One option for non-exchange revenues
  - Expense alternatives presented
    - No additional guidance for exchange expenses
    - Two options for non-exchange expenses
  - Advantages and disadvantages of the overall approach
  - Advantages
    - Exchange/non-exchange approach is foundational in the public sector. Includes references to Conceptual Framework.
    - The approach is familiar to preparers. Although issues were described by some preparers related to implementation, others did not indicate significant challenges.
    - Judgment will be necessary using either approach. The judgments necessary for the exchange/non-exchange approach have been encountered, while those necessary for the performance obligation approach have not yet been identified.
  - Disadvantages
    - Challenges exist in the determination of the exchange/non-exchange nature of many transactions in the public sector. Wide range of views regarding the character of the majority of transactions in the public sector, from all are exchange to all are non-exchange.
    - Challenges exist in the classification of transactions as exchange or non-exchange. Significant judgment has been required using current guidance.
    - Distinction between exchange and non-exchange is not that relevant or prevalent in the presentation of financial statements.
  - Revenue alternatives
  - Exchange
    - Pure IFRS 15 approach
      - Pure IFRS 15 for those that meet criteria
      - Transactions that do not meet IFRS 15 are out of scope
      - Exchange classification of transactions is first step

- Advantages and disadvantages of this alternative
- Modified performance obligation approach (Category A and some Category B)
  - Similar modification proposed in Chapter 2
  - Difference is that only exchange transactions would be included; non-exchange are not included as they are in Chapter 2
- Non-exchange (*See Separate Presentation Slides*)
  - Modified IPSAS 23 (modified IPSAS 23 may not produce the same recognition standards as Category B and C of performance obligation approach)
    - Expense alternatives
- Exchange are out of scope
- Non-exchange
  - Non-exchange Alternative 1: IPSAS 19 Approach
    - Modifications to IPSAS 19 include: (1) modify the scope to include non-exchange transactions of resource providers that are not social benefits; (2) add examples of non-exchange transactions to the implementation guidance; (3) modify the threshold for recognition of provision from “more likely than not” to “little to no realistic alternative to avoid” for conceptual consistency; and (4) replace the term “constructive liability” with “non-legally binding obligation.”
    - Advantages include flexibility to preparers and inclusion of consideration of future events to be reflected in the provision.
    - Disadvantages include potential for confusion regarding modification of recognition threshold and lack of specificity in IPSAS 19.
  - Non-exchange Alternative 2: IPSAS 23 Approach
    - Modification to IPSAS 23 to address implementation issues (*See Separate Slides*)
    - Modification to decision tree steps in IPSAS 23 for provider view with flowchart included.
      - Begin with evaluation of whether an outflow has occurred.
      - Change current requirement to evaluate whether it’s more likely than not that an inflow/outflow will occur to evaluate if there is little to no alternative to avoid the outflow.
    - Advantages include familiarity with IPSAS 23 for revenue transactions and inclusion of guidance for transactions that include both exchange and non-exchange components.
    - Disadvantages include difficulty in classifying transactions as exchange and non-exchange, potential difficulty in using the revenue approach for expenses, and difficulty in determining the point at which a liability arises.

## Chapter 4: Measurement

- Revenues (*No Agenda Items at this meeting*)
  - Initial measurement of revenue transactions – entitlement approach (revenue measured on a gross transaction amount basis) versus expected revenue approach (revenue measured on a net amount basis, the amount expected to be received at the commencement of the arrangement)
  - Other performance obligation measurement considerations:
    - Variable consideration
    - Recognition of financing components
    - Non-cash consideration
- Non-Exchange Expenses (*Refer to March 2016 Agenda Item 11.1 – Measurement, no agenda items at this meeting*)
  - Cost of fulfillment is the most appropriate measurement basis
  - Consistent with social benefits
  - Probability evaluation consistent with Conceptual Framework

## Appendix A: Overview of Existing IPSASs

*Consultation Paper Draft Appendix Complete (Agenda Item 11.10)*

## Appendix B: Preparer Interviews

*Consultation Paper Draft Appendix Complete (Agenda Item 11.10)*

## Appendix C: Decision Trees

*Consultation Paper Draft Appendix Complete (Agenda Item 11.10)*

- Depict each approach with alternatives
- Present the overall view of each approach with commentary to guide analysis
- Diagrams may change based on any changes made to CP Chapters

## Appendix D: Illustrative Examples

*Consultation Paper Draft Appendix Complete (Agenda Item 11.10)*

- Apply both approaches described
- Use to illustrate how each approach may address the issues raised by constituents
  - Difficulty in determining exchange vs. non-exchange classification
  - Stipulations rarely result in liability recognition
- Use some examples between public sector entities that have been used throughout the project
- Capital grants
- Multi-year funding
- Transactions with private sector entities
- With performance obligations
- Without performance obligations
- Also include taxes and exchange transactions with constituents

**ISSUES PAPER, *REVENUE AND EXPENSES*—CONSULTATION PAPER  
SCOPE****Objectives of this Paper**

1. Throughout the discussions of issues related to this project, one recurring topic has been the scope of the consultation paper. Questions have been raised by both project staff and IPSASB members regarding the transactions that will be considered within the scope of the consultation paper and the interaction of those transactions with both existing guidance and proposals for future guidance.
2. This paper aims to clarify some boundaries of the scope of the consultation paper. To accomplish this goal, this paper first addresses the whether the scope of the transactions addressed should be dependent on the approach (performance obligation versus exchange/non-exchange). The paper then classifies transactions and guidance related to the recognition of revenue or expense by public sector entities into two categories for the performance obligation approach. These categories are defined as: (a) transactions that are proposed to be included in the scope of the consultation paper and (b) transactions that are proposed to be excluded from the scope of the consultation paper.

**Background**

3. The original project briefs described the initial scope considerations. The Revenue project originally intended to cover exchange and non-exchange revenue transactions. The scope of that project indicated that the resulting guidance would supersede or amend the guidance currently contained in the following International Public Sector Accounting Standards (IPSASs):
  - IPSAS 9, *Revenue from Exchange Transactions*;
  - IPSAS 11, *Construction Contracts*; and
  - IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.Discussion of the revenue project also described statutory receivables as within scope.
4. The non-exchange expense project originally intended to address recognition and measurement requirements applicable to providers of non-exchange transactions, except for social benefits.
5. Although multiple discussions regarding scope of the consultation paper have occurred, the discussions have primarily explored potential expansion of the scope of the project to include additional transactions, which are discussed later in this paper.
6. Through review of the scope of the revenue guidance noted above, revenue arising from the following transactions are included in the scope of the consultation paper:
  - Rendering of services;
  - Sale of goods;
  - Construction contracts; and
  - Non-exchange transactions.

7. Non-exchange transactions that give rise to revenue include taxes and transfers. Transfers includes such items as grants, debt forgiveness, fines, bequests, gifts, donations, goods and services in-kind, and the off-market portion of concessionary loans received.
8. The project brief on non-exchange expenses identified the need to develop recognition guidance for providers of non-exchange transactions that are not social benefits. The consultation paper will therefore include those transactions. The current project on social benefits is considering the definition of social benefits and which transactions will meet the definition of a social benefit and therefore be within the scope of the social benefits guidance. This project will include those transactions that are not considered to be within the scope of the social benefits project.

### **Non-Exchange Expenses versus Expenses**

9. As the project progressed, the overlap of transactions between public sector entities was explored. At multiple points, it was noted that revenue to one public sector entity may be an expense of another public sector entity. During the deliberations, the IPSASB explored the potential application of the performance obligation approach to both exchange and non-exchange expenses. Transactions without performance obligations would be subject to separate guidance.
10. To develop a comprehensive view of the effects of the performance obligation approach, the IPSASB has tentatively decided to explore the application of this “new thinking” to certain exchange expenses. This tentative decision raises the issue of which expenses will be considered in the scope of the consultation paper and whether current guidance that already exists for those transactions is sufficient given the changes introduced with this approach.
11. Expanding the scope to include exchange expense transaction was not proposed for exchange/non-exchange approach primarily because it does not introduce a new recognition method. At this point, no compelling reason has been identified to expand the scope if the traditional recognition approach is retained.
12. As a result, certain transactions may or may not be included in the scope of the consultation paper, depending on the approach considered. As mentioned above, exchange expenses with performance obligations, other than those described below, will be considered in the consultation paper section that describes the performance obligation approach. In contrast, in the section describing the exchange/non-exchange approach, exchange expenses are considered to be out of scope.
13. After the consultation paper responses are received and the IPSASB determines the approach to pursue, these transactions are expected to be evaluated again for inclusion or exclusion in the proposed guidance at the Exposure Draft phase.

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

1. The IPSASB is **asked** if it agrees with the proposal to include exchange and non-exchange expenses in the performance obligation approach and only non-exchange expenses in the exchange/non-exchange approach.

### **Performance Obligation Approach—Guidance that May be Affected**

14. As the IPSASB considered the potential expansion of the scope of the non-exchange expenses project, IPSASB members also considered existing guidance related to all expenses. A review of current guidance was discussed by the IPSASB during the December 2015 meeting.

15. In addition to the three standards previously cited in paragraph 3 that are primarily related to revenue recognition, there are additional IPSASB standards where it may be necessary to consider the effect of the performance obligation approach on these standards, or otherwise consider conforming changes. The guidance included in this category includes:
- IPSAS 12, *Inventories*;
  - IPSAS 17, *Property Plant and Equipment*; and
  - IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*.

**Matter(s) for Consideration**

2. The IPSASB is **asked** if it agrees with the description of guidance that may be affected if the performance obligation approach is pursued after the consultation paper.

**Performance Obligation Approach—Transactions Not Included in the Scope of the Consultation Paper**

16. The final category of transactions to consider are those that are excluded from the scope of the proposed consultation paper. Certain transactions are proposed to be excluded from the scope of the proposed consultation paper for two primary reasons, which are (1) specific exchange expenses are within the scope of existing IPSASB literature and those recognition standards include issues that may be not adequately addressed by basic performance obligation guidance; and (2) transactions within the scope of current IPSASB projects that are expected to include issues that may be not adequately addressed by basic performance obligation guidance.

*Exchange Expenses in Existing IPSASB Literature*

17. As mentioned previously, although the IPSASB tentatively agreed to expand the scope of the expenses project to allow for evaluation of the performance obligation approach, the IPSASB did not intend to revise existing guidance for exchange expenses. This section describes those exchange expenses that were identified as in the scope of existing literature in the December 2015 meeting.
18. Expenses that are proposed to be excluded from the scope of the consultation paper include the following:
- Borrowing costs in the scope of IPSAS 5, *Borrowing Costs*;
  - Leases in the scope of IPSAS 13, *Leases* (also see discussion of leases below);
  - Interest expense related to investment property in the scope of IPSAS 16, *Investment Property*;
  - Costs associated with employee benefits in the scope of IPSAS 25, *Employee Benefits*; and
  - Expenses related to intangible assets in the scope of IPSAS 31, *Intangible Assets*.

*Transactions in IPSASB Projects*

19. The IPSASB currently has several projects either in progress or soon to be initiated. The transactions included in those projects also are proposed to be excluded from the scope of the proposed consultation paper.
20. These transactions are also excluded from the scope of the proposed consultation paper, including:
- Leases, including both expense and revenue;

- Social benefits;
- Public sector specific financial instruments;
- Financial instruments; and
- Public sector combinations.

21. IPSAS 23 currently includes revenue from the use by others of entity assets yielding interest, royalties, and dividends or similar distributions. These transactions are also excluded from the scope of the proposed consultation paper as the recognition of revenue from these items would be considered in the project on financial instruments.

*Transactions Excluded from Current Revenue Guidance*

22. Current guidance for revenue transactions included in IPSAS 9, IPSAS 11, and IPSAS 23 excludes certain transactions. These transactions are proposed to be excluded from the scope of the proposed consultation paper. Therefore, revenue arising from the following transactions are excluded:

- Leases;
- Dividends or similar distributions arising from investments that are accounted for under the equity method;
- Gains from the sale of property, plant, and equipment;
- Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;
- Changes in fair value of financial assets and financial liabilities or their disposal;
- Changes in the value of other current assets;
- Initial recognition of, and changes in, the fair value of biological assets related to agricultural activity;
- Initial recognition of agricultural produce;
- Extraction of mineral ores; and
- Entity combinations.

**Matter(s) for Consideration**

3. The IPSASB is **asked** if it agrees with the description of transactions that are proposed to be excluded from the scope of the consultation paper.

**REVENUE AND EXPENSE CONSULTATION PAPER DRAFT****Chapter 1: Introduction**

- 1.1 Since its inception, the IPSASB has developed a number of standards that address the accounting for a wide range of transactions and events, and that acknowledge the characteristics of public sector entities. Through its ongoing work program the IPSASB aims to improve its standards and develop guidance on topics not currently addressed at a standards level. This Consultation Paper seeks feedback on two related matters: possible improvements to the accounting for revenue and potential guidance for the accounting for expenses.
- 1.2 The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. To evaluate the performance of such entities, users need information regarding the financial position, financial performance, and cash flows of an entity, as well as information regarding the following:
- Provision of services to constituents;
  - Resources currently available for future expenditures, including restrictions or conditions attached to the use of those resources;
  - Burden on future tax-payers for current services; and
  - Changes in the entity's ability to provide services compared with the previous period.
- 1.3 Public sector entities raise or obtain funds through a variety of methods, including taxation, transfers from other public sector entities, and charges for goods and services provided. Public sector entities use the resources obtained to provide services to the public through different types of transactions. Some public sector entities provide services directly to citizens, while others may contract with other entities to provide services on behalf of the public sector entity that initially receives the resources. Public sector entities provide resources to other public sector entities through transfers, grants, and other arrangements.
- 1.4 Currently, International Public Sector Accounting Standards (IPSASs) differentiate in certain circumstances between exchange transactions and non-exchange transactions. Current literature includes the following definitions for those transactions:

## Exchange transactions:

transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

## Non-exchange transactions:

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

- 1.5 Existing IPSASs provide guidance on a range of revenue transactions. The three main standards providing guidance for revenue transactions are:
- IPSAS 9, *Revenue from Exchange Transactions*;
  - IPSAS 11, *Construction Contracts*; and
  - IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.
- 1.6 A number of IPSASs provide guidance on the recognition of expenses and liabilities but there is currently very little guidance on the recognition of expenses and liabilities arising from non-exchange transactions. Although IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* was the result of a convergence project and was not specifically developed with non-exchange transactions in mind, it is used as a source of guidance for the recognition of provisions for non-exchange transactions. At the time that IPSAS 19 was developed, the IPSASB decided to exclude social benefits from its scope. The IPSASB now has a project underway to develop guidance for social benefits provided by public sector entities. However, a gap exists for transactions that are not within the scope of either the existing guidance for exchange expenses or potential guidance related to social benefits.
- 1.7 Additional background on the development of IPSASs 9, 11, 19, 23, and other relevant IPSASs, as well as an overview of key provisions of these IPSASs, is provided in Appendix A to this Consultation Paper (CP).

### **Current Environment**

- 1.8 The IPSASB considers this an appropriate time to seek feedback from constituents on accounting for revenue and expenses for several reasons. First, constituents have identified implementation issues with both IPSAS 19 and IPSAS 23. Second, in 2014 the International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*, which will replace International Accounting Standard (IAS) 11, *Construction Contracts* and IAS 18, *Revenues*. The performance obligation approach used in IFRS 15 represents new thinking for the recognition of revenue in the private sector and provides an opportunity to reexamine the IPSASs dealing with revenue. Finally, the IPSASB completed *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (“Conceptual Framework”) in October 2014, which provides an overarching framework for the consideration of financial reporting.
- 1.9 This CP is an important step in improving guidance for public sector entities for the appropriate reporting of revenues and expenses. The CP builds on current IPSASB guidance and considers new thinking related to performance obligations. The CP describes two potential approaches to the recognition of revenues and expenses of public sector entities. The objective of the CP is to initiate a debate about matters such as:
- scope of potential guidance related to revenues and expenses;
  - approaches to recognition of revenues of public sector entities;
  - approaches to recognition of expenses of public sector entities that are not addressed in transaction-specific standards; and
  - symmetry of accounting between resource providers and resource recipients.

### *Implementation Issues*

- 1.10 In order to obtain feedback from constituents regarding the specific issues to be addressed within this project, the IPSASB interviewed preparers of public sector financial statements. Efforts were made to select interview participants that prepare financial statements for different sizes and types of entities; however, the participants were not selected using a random process, nor were the findings analyzed using statistical techniques. A relatively small number of participants were interviewed. Consequently, while the information from the interviews may represent some views that exist in the larger population of preparers, the results are not generalizable and may not represent all views in the population.
- 1.11 Preparers were asked to share their experiences of accounting for non-exchange revenue and expenses, including transactions with timing and purpose restrictions. Preparers described practical issues in the application of IPSAS 23, specifically related to the treatment of stipulations and the timing of recognition for multi-year agreements. Preparers also described difficulty in classifying transactions as exchange or non-exchange. While preparers noted these difficulties, the preparers did not indicate disagreement with the conceptual basis of the guidance regarding non-exchange transactions. Additional details of the results of the preparer interviews are included as Appendix B to this CP and are referenced throughout the remaining Chapters of this CP.

#### *New Private Sector Recognition Model*

- 1.12 As previously noted, the IASB recently issued IFRS 15. The IASB initiated its project to clarify the principles for recognizing revenue. The core principle of IFRS 15 is that entities recognize revenue for the amount of consideration due to an entity in exchange for the goods and services provided to the customer. Revenue recognized should reflect the transfer of control of the asset to the customer and the amount of revenue recognized should be equal to the consideration the entity is entitled to for satisfying the performance obligation.
- 1.13 The performance obligation model described in IFRS 15 is used as a key reference point for the development of the performance obligation approach described in Chapter 2 of this CP.

#### *Conceptual Framework*

- 1.14 The Conceptual Framework establishes the objectives and qualitative characteristics of financial reporting, which provides a framework against which various approaches described in this CP are evaluated.
- 1.15 The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial reports for accountability purposes or decision-making purposes. The results of any final guidance related to the provision of exchange and non-exchange transactions may be relevant to meeting a variety of information needs of service recipients and resource providers, including assessing an entity's:
- Performance during the reporting period;
  - Liquidity and solvency;
  - Ability to sustain the services it delivers and other operations over the long term; and
  - Capacity to adapt to changing circumstances.

- 1.16 Information from the proper reporting of revenues and expenses is essential to assessing accountability. As described in the Conceptual Framework, public sector entities are accountable to both those who provide resources to the public sector entity and those that depend on the public sector entity to use those resources to deliver services during the reporting period and over the longer term. Public sector entities must demonstrate accountability for the management of resources entrusted to them for the delivery of services.
- 1.17 Information about revenues and expenses also supports decision making. Information about costs and resources available to support activities will be useful to resource providers in the determination of resources provided to the entity.
- 1.18 The Conceptual Framework introduced updated definitions of the elements in financial statements, including assets, liabilities, revenues and expenses. These definitions have influenced the IPSASB's consideration of when revenue and expenses should be recognized for non-exchange transactions, including consideration of the potential use of other resources and other obligations. When one views the basic provision of non-exchange transactions, the recognition of expense by the resource provider and the recognition of revenue by the resource recipient automatically comes to mind. However, if a resource is provided in advance, an asset or other resource or a liability or other obligation could result.

### **History and Scope of the Projects**

- 1.19 In March 2015, the IPSASB approved project briefs on Revenue and Non-Exchange Expenses. The revenue project brief proposed a single revenue project to update the IPSASB's requirements and guidance on exchange and non-exchange revenue. The project would lead to one or more new standards that would replace IPSAS 9, IPSAS 11, and IPSAS 23. IPSAS 9 and IPSAS 11 were developed as part of the IPSASB's first phase of work to develop a core set of IPSASs based, to the extent appropriate, on IASs. These were referred to as convergence projects and IPSAS 9 and IPSAS 11 were drawn primarily from IAS 18 and IAS 11, respectively. By contrast, IPSAS 23 was developed from first principles to address public sector specific issues. Although the current project is not intended to be a convergence project, the approach described in IFRS 15 is one of the major approaches considered throughout the project and presented in this CP.
- 1.20 Current guidance for certain expenses, including non-exchange transactions, is presented in IPSAS 19. IPSAS 19 was developed as a convergence project and was drawn primarily from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
- 1.21 IPSAS 19 specifically excludes provisions and contingent liabilities arising from social benefits from its scope. This scope exclusion has meant that IPSASs have not addressed accounting for social benefits. In order to address the accounting and financial reporting of social benefit programs the IPSASB has initiated a project on that topic and issued a Consultation Paper, *Recognition and Measurement of Social Benefits*, in 2015. The social benefits CP sought feedback on issues associated with accounting for social benefits, which are non-exchange transactions; however, it did not address all non-exchange transactions in which public sector entities provide resources. Although IPSAS 19 is regarded as a source of guidance on accounting for non-exchange transactions other than social benefits, neither IPSAS 19, nor other IPSASs, specifically address such transactions.
- 1.22 To evaluate the effects of any approach to the recognition of revenue by resource recipients and expense by resource providers in the public sector, one must consider the effects on both parties to

the transaction. To fully grasp the ramifications of a particular approach, the IPSASB agreed that a single consultation paper should be presented that describes the effects of the recognition approaches for both sides of a transaction—that is, the recognition of revenue by a recipient and the corresponding recognition of expense by a resource provider.

- 1.23 Two approaches to recognition of revenue and expense are presented in this CP: (1) the performance obligation approach and (2) the exchange/non-exchange classification approach. These approaches are described in separate Chapters in this CP. The transactions within the scope of this CP will depend upon both the overall approach selected and the interaction with other projects and pronouncements described below.
- 1.24 The revenue transactions within the scope of this CP are those transactions currently within the scope of IPSAS 9, IPSAS 11 and IPSAS 23 with one exception. Revenue that arises from use by others of entity assets yielding interest, royalties, and dividends or similar distribution currently within the scope of IPSAS 23 is not within the scope of this CP, but will be considered in a separate project on financial instruments. Apart from considering the impact of any new and improved revenue standards on other IPSASs, transactions giving rise to revenue that are currently addressed by other IPSASs are not within the scope of this CP.

*Interaction with Other Projects and Pronouncements*

- 1.25 Transactions that are within the scope of existing IPSASs for expenses are not within the scope of this CP. For example, transactions that give rise to expenses from employee benefits are within the scope of IPSAS 25, *Employee Benefits* and are not within the scope of either approach described in this CP. A complete list of the expenses not within the scope of this CP because the expenses are in the scope of existing IPSASs for expenses is included in Appendix A to this CP.
- 1.26 Transactions that are within the scope of potential social benefits guidance would not be included in the scope of this CP. Transactions that are within the scope of IPSASB projects on leases, public sector financial instruments, financial instruments, and public sector combinations would not be included in the scope of this CP.

**Approach of this CP**

- 1.27 This CP draws on the Conceptual Framework, existing IPSASB guidance, feedback from preparers, and the performance obligation recognition model from the IASB to consider two approaches to the recognition of revenues and expenses by public sector entities. As previously noted, the CP first describes the following two approaches to recognition:
  - Performance Obligation Approach; and
  - Exchange/Non-exchange Classification Approach.
- 1.28 These approaches are explored in Chapters 2-3, including discussion of alternatives to each approach. Some of the discussion in Chapter 2, such as consideration of the potential modifications to IPSAS 23, is also presented in Chapter 3 so that those potential modifications can be considered in the context of each approach. Although the modifications may be similar within the two overall approaches, application of the modifications may provide different results.

- 1.29 Chapter 4 describes measurement for revenues and expenses. Appendix C to the CP presents decision trees for the two approaches described. To illustrate the application of each of the approaches above, Appendix D presents a series of examples.

**ISSUES PAPER, *NON-EXCHANGE EXPENSES—APPLICATION OF PERFORMANCE OBLIGATION MODEL TO EXPENSE TRANSACTIONS*****Introduction**

1. The use of a performance obligation model has been explored for the recognition of revenue by public sector entities, which will be presented as a potential approach in the joint Consultation Paper for revenues and expenses. To present a comprehensive view of the approach, the performance obligation approach could be applied to recognition of expenses.
2. The performance obligation model used in International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers* issued by the International Accounting Standards Board (IASB) was developed for the recognition of revenue. The approach presented in this paper covers new ground as it considers the application of a performance obligation model to the recognition of expenses.
3. This paper will describe the application of a performance obligation approach, both as the approach used in IFRS 15 and an expanded performance obligation approach, to expense transactions. To illustrate the application of the performance obligation approach to expense transactions, this paper begins with the same categories of transactions that have been previously introduced in the discussion of revenues, as well as the advantages and disadvantages of the application of a performance obligation approach to expense transactions.
4. Category A has been used in previous papers and the proposed draft of the Consultation Paper (CP) to include revenue transactions that are within the scope of IFRS 15. The CP draft proposes that the performance obligation approach for revenue transactions in Category A will be converged with IFRS 15. Expense transactions are not included in Category A and therefore Category A will not be used in this paper.
5. Category B transactions are used in this paper to illustrate the application of a performance obligation approach to expense transactions. Category B transactions are those in which there is some form of performance obligation, but some of the criteria for use of the model defined in IFRS 15 are not satisfied. The performance obligations may not be distinct, as the benefits may not be provided directly to the resource provider. The obligations may not be enforceable through a contract, but may be enforceable through other means. Transactions included in this category could include transactions that involve the provision of goods and services to a third party, as well as capital grants, research grants, and other general forms of funding provided to a recipient. These transactions may be classified as exchange or non-exchange transactions in current terminology, and may have either conditions or restrictions. In addition, because Category A does not include expense transactions, transactions in which the public sector entity is the direct recipient of purchased goods or services, or an exchange transaction in current terminology, also are included in Category B for the expense discussion.
6. Category C transactions do not have performance obligations. The performance obligation approach will not be appropriate for these transactions; therefore an approach to recognition of these

transactions will need to be developed. Category C transactions are not discussed in the remainder of this paper.

## Category B Expenses – Direct Relationship

7. For the application to expenses, Category B includes transactions in which the public sector entity is the direct recipient of goods or services promised in a contract. A simple example to consider is a transaction in which a central government enters into a contract for consulting services that result in a private firm providing a professional opinion to the central government. The central government will pay the private firm a fee of CU100,000 for the consulting services. If the central government terminates the contract for reasons other than the private firm’s failure to perform as promised, the contract requires the central government to compensate the private firm for its costs incurred plus a 5 percent margin, which approximates the profit margin that the private firm earns from similar contracts.
8. The performance obligation approach used in IFRS 15 uses the terms *entity* and *customer* for the two parties in a contractual relationship. Public sector entities may enter into contracts for services, such as the one described in this example, or they may enter into other forms of agreements in which they are not the direct recipient of goods or services, as described in the next section. To evaluate a transaction from the perspective of the party paying for the goods or services, clarification of the terminology may be necessary. For purposes of this analysis, the following terms will be used:
  - **Customer:** A party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.
  - **Entity:** A party that has contracted with a customer to provide goods or services in exchange for consideration.
  - **Resource Provider:** A party that has entered into an arrangement or agreement with a resource recipient to provide goods or services to a party other than the resource provider.
  - **Resource Recipient:** A party that has entered into an arrangement or agreement with a resource provider to provide goods or services to a party other than the resource provider.

### Matter(s) for Consideration

1. The IPSASB is **asked** if it agrees with the proposed terms to describe the parties involved in expense transactions.

9. The following table describes how the central government could evaluate the contract for consulting services using the steps in a performance obligation model modified to consider expense transactions and using the terminology described above:

<b>Steps to apply a performance obligation approach – central government is a customer</b>	
Step 1 – Identify the contract with the entity.	<ul style="list-style-type: none"> <li>• The parties to the contract, the entity (private firm) and the customer (central government), can be identified and have approved the contract.</li> <li>• Each party’s rights to services to be transferred can be identified.</li> <li>• The payment terms are identified.</li> <li>• The contract has commercial substance.</li> </ul>

	<ul style="list-style-type: none"> <li>The customer (central government) intends to pay for the services in the contract and payment is considered probable. The agreement between the customer (central government) and the entity (private firm) satisfies the criteria for a contract.</li> </ul>
Step 2 – Identify the performance obligations in the contract.	The performance obligation is the promise from the private firm to provide consulting services to the central government.
Step 3 – Determine the transaction price.	The transaction price of CU100,000 is specified in the contract.
Step 4 – Allocate the transaction price.	This contract includes one performance obligation. The entire transaction price is allocated to the consulting services.
Step 5 – Recognize expense when (or as) a performance obligation is satisfied.	<p>IFRS 15 describes the following criteria for recognition over time in paragraph 35:</p> <p><i>An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:</i></p> <p><i>(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);</i></p> <p><i>(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or</i></p> <p><i>(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).</i></p> <p>The benefit of the private firm's performance, or work to form a professional opinion, is not received by the central government until the opinion is complete and delivered to the central government. The criteria in paragraph 35 (a) is therefore not satisfied.</p> <p>The criterion in paragraph 35(b) is not applicable to this example. Paragraph 35(c) does apply and could be evaluated in a manner similar to that in Example 14 provided in IFRS 15. The private firm's performance does not create an asset with an alternative use to the private firm as the professional opinion relates to the facts and circumstances specific to the central government. The work does not create an asset that can be redirected to another customer. Based on the terms of the contract, the private firm has an enforceable right to payment for performance completed to date.</p> <p>This contract therefore meets the requirements specified in IFRS 15.35 (c) for recognition over time. As the private firm provides consulting services to satisfy the performance obligation, the central government recognizes expense. The private firm would also recognize revenue as services are provided.</p> <p>If progress payments are made as the services are provided, the central government recognizes a decrease in cash. If not, the central government recognizes a liability.</p>

10. Recognition of the liability by the central government as the performance obligation is satisfied by the private firm results in a conceptually sound recognition model. The central government has little to no realistic alternative to avoid the outflow of resources because the private firm has satisfied the performance obligations specified in the contract. The contract is enforceable and the amount of the liability is known from the contract terms. Therefore, as the private firm satisfies the performance obligation to provide services defined in the contract, that satisfaction creates a present obligation of the central government. Although the contract imposes a performance obligation on the private firm to provide services to the central government, there is no performance obligation to the central government. The present obligation of the central government is a result of past event and requires an outflow of resources, meeting the definition of a liability in the Conceptual Framework.
11. Consistent with the evaluation of the performance obligation model described in the Revenue project, the performance obligation model described above can be applied to expense transactions in which the public sector entity directly receives goods or services.

### Category B Expenses – No Direct Relationship

12. Application of the performance obligation model is more complex for Category B transactions that do not involve the direct transfer of goods or services to the public sector entity providing consideration. In these examples, the public sector entity is referred to as the resource provider and the entity receiving the consideration is the resource recipient. To illustrate the complexity, three types of transactions are described from a resource provider view. These transactions were discussed at prior meetings and include a three-party transaction, a capital grant, and a grant for a specific program.

#### *Three-Party Transaction*

13. In the December 2015 agenda papers, the revenue project evaluated the application of the performance obligation approach to a grant currently classified as a non-exchange transaction, but that has a performance obligation that is clearly defined. That example of a vaccination grant is described below to evaluate the application of a performance obligation approach from a resource provider view.

	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	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 central government 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.
Availability of funds	The central government has authority to spend the funds.

Eligibility criteria	No specific criteria over and above the specifications set out above.
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14. The application of the performance obligation model to the expense of the resource provider is described in the following table:

<b>Steps to apply a performance obligation approach – central government providing grant funds for specific services.</b>	
Step 1 – Identify the contract with the resource recipient.	<ul style="list-style-type: none"> <li>• The parties to the agreement, the central government providing resources and the public sector entity receiving resources, can be identified and have approved the agreement.</li> <li>• Each party's rights to services to be transferred can be identified.</li> <li>• The payment terms are identified.</li> <li>• The agreement has commercial substance.</li> <li>• The public sector entity intends to pay for the service provided by the local government described in the agreement and payment is considered probable.</li> </ul> <p>In this example, the central government has the authority to spend the funds. In certain jurisdictions, a public sector entity may need to have an approved authorization or appropriation prior to providing funding. In addition, that authorization or appropriation may need to be effective or not be able to be revised or revoked by the entity's governing body in order to be binding. The effects of an approved, effective, authorization or appropriation may need to be considered on a jurisdictional basis.</p> <p>The agreement between the central government and the local government satisfies the criteria for an agreement within the scope of the model.</p>
Step 2 – Identify the performance obligations in the contract.	The performance obligation is the promise from the local government to perform the vaccination services for the central government. Each vaccination is a distinct service and the promises in respect of the vaccinations are explicitly stated in the agreement.
Step 3 – Determine the transaction price.	Assuming the cost of each vaccination is CU10, and that the central government expects the local government to perform the maximum number of vaccinations allowed in the contract, or 500 vaccinations, the central government would expect to pay: $CU10 \times .5 \times 500 = CU2,500.$
Step 4 – Allocate the transaction price.	Each vaccination represents a single performance obligation. The transaction price of CU2,500 is allocated to each vaccination. CU5 is recognized as expense as each vaccination service is provided.
Step 5 – Recognize expense when (or as) a performance obligation is satisfied.	As the local government satisfies the performance obligation by providing vaccinations, the central government would recognize expense. The number of vaccinations performed would be an appropriate measure of progress to determine how much expense should be recognized as the performance obligation is satisfied. The services provided in this example are not capital in nature; therefore, no asset would be recognized.

	If payment is made immediately, the public sector entity recognizes a decrease in cash. If not, the public sector entity recognizes a liability.
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15. As the local government satisfies the performance obligation by providing the vaccinations, the central government has little to no realistic alternative to avoid the outflow of resources specified in the grant agreement. Recognition of a liability at that point is therefore consistent with the Conceptual Framework.
16. If the central government provides the funding for this agreement up-front, prior to any services performed by the local government, the central government needs to evaluate the outflow of resources. The performance obligation specified in the agreement has not been met by the local government; therefore, the local government would recognize the payment of funds as an advance, or a liability. The central government still controls those resources and therefore recognizes an asset for the advance payment.

*Capital Grant*

17. In this example of a Category B transaction that does not involve transfer of goods or services to the resource provider, consider a transaction in which a central government (resource provider) enters into an agreement to provide funding to a local government (resource recipient) for a portion of construction of a specific highway. The agreement states that the central government will pay 50% of the cost of the road construction, up to a maximum of CU20 million. The road is constructed by a general contractor that is chosen through a bid process managed by the local government with approval from the central government. The final bid accepted is for construction costs totaling CU50 million.

<b>Steps to apply a performance obligation approach – central government provides grant funding for a capital project.</b>	
<p>Step 1 – Identify the contract with the resource recipient.</p>	<ul style="list-style-type: none"> <li>• The contract between the central government and the local government creates enforceable rights and obligations.</li> <li>• The contract has been approved by both parties and the payment terms can be identified by both the central government and the local government.</li> <li>• The rights to goods and services <i>to be transferred</i> is not as easily applied in this example, as there is no transfer of the road from the local government to either the central government or to another party. The potential expansion of the model explored for revenue recognition in the public sector would include identification of the obligation to construct the road as the performance obligation of the local government. A similar expansion of the model could be considered from the resource provider view. The central government may have an enforceable right to construction of the road by the local government for the central government to have an obligation to provide funds. Even though no transfer of the road is contemplated, there are still arguably rights and obligations that can be enforced.</li> <li>• The contract has commercial substance and it is probable that the central government will pay the grant to the local government.</li> </ul> <p>The grant agreement could be within the scope of the expanded model.</p>

<p>Step 2 – Identify the performance obligations in the contract.</p>	<p>This contract does not include a promise from the local government to transfer control of the road to the central government. One modification to the performance obligation approach that has been proposed is to define a performance obligation as a promise to transfer a good or service to agreed recipients that is sufficiently specific. To be sufficiently specific, the entity should have the ability to demonstrate to the resource provider the obligation to deliver the promised goods or services has been satisfied.</p> <p>If that modification to the performance obligation approach were made, the local government and the central government could identify the obligation of the local government to construct the road as a performance obligation. The local government has the ability to demonstrate to the central government that the road has been constructed.</p> <p>If the local government does not build the road, the central government is not obligated to pay resources to the local government.</p>
<p>Step 3 – Determine the transaction price.</p>	<p>The transaction price is 50% of the cost of road construction, up to a maximum of CU20 million, that the central government expects to pay to the local government.</p>
<p>Step 4 – Allocate the transaction price.</p>	<p>If the contract is determined to have constructing the road as the sole performance obligation, the entire transaction price is allocated to the road construction.</p>
<p>Step 5 – Recognize expense when (or as) a performance obligation is satisfied.</p>	<p>The criteria described in the Category A example for recognition over time would need to be revised in a similar manner to replace the notion of the transfer of control, but the premise of the criterion in could be applicable to this example.</p> <p>The local government’s performance does not create an asset with an alternative use to the local government and creates an enforceable right to payment.</p> <p>As road construction is completed, the local government satisfies the performance obligation.</p> <p>The central government likely has the ability to require the local government to demonstrate satisfaction of the performance obligation through periodic reporting even though control of the road is not transferred to the central government.</p> <p>The central government recognizes expense as the road is being constructed (over time) for the central government’s share of the costs incurred to date, up to the maximum amount specified in the contract.</p> <p>If payment is made immediately, the central government recognizes a decrease in cash. If not, the central government recognizes a liability.</p>

18. Recognition of the liability by central government when the performance obligation is satisfied by the local government results in a conceptually sound recognition model. The central government has little to no realistic alternative to avoid the outflow of resources because the local government has satisfied the performance obligations specified in the agreement. The contract is enforceable and the amount of the liability is known from the contract terms.

19. In some arrangements like the one described above, the central government will provide funding in advance of the start of the project. In such cases, the funding has been provided in advance of the satisfaction of the performance obligation by the local government. The local government records the advance as a liability that is recognized as revenue as the performance obligation is satisfied. From the view of the central government, or resource provider, the funds paid in advance could be recorded as an asset. The central government controls those resources until they are used for their intended purpose by the local government to satisfy the performance obligation.

*Grant for Specific Program*

20. Grants for a specific program classified as Category B may be one in which the grant specifies the program that should use the funds, but does not specify which goods or services should be purchased using the grant funds in order to carry out that program. There is an obligation to spend the funds to support a program, but the grant does not require use of the funds for a particular good or service. The obligation in this case is a stipulation as described in International Public Sector Accounting Standard (IPSAS) 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. If the stipulation includes a provision requiring funds to be returned if they are not used in the manner specified, the stipulation is a condition. If not, it is a restriction.
21. The interaction between performance obligations and stipulations is described in paragraph 15 of IPSAS 23 as follows:

Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached (return obligation).

22. Although a requirement to use grant funds to support a particular program imposes a restriction upon the recipient, the restriction is not sufficiently specific or enforceable to be considered a performance obligation. A condition that imposes a return obligation on a recipient if the funds are not used as specified may meet the definition of a performance obligation.
23. To illustrate the application of the performance obligation approach to a grant with a condition, consider the following example adapted from the December 2015 papers for a grant to a local government health department to provide dental services. In the example, the grant is to support the dental services in general, but there is no specification of the exact services to be provided, or particular goods to be purchased to support the provision of dental services. If the funds are not spent to support the dental services, the funds must be returned to the central government.

	A central government provides a grant to a local government health department to support the provision of dental services.
Specifications	Specific goods or services are not specified. Funds are to be used to support dental services provided by the local government health department. Funds not used in this manner must be returned to the central government. The local government must provide periodic reporting to the central government regarding the dental services provided,

	including types of services, number of patients served, and total costs incurred by the dental services unit.
Cost	CU200,000.
Availability of funds	The central government is authorized to provide the grant.

24. If the performance obligation approach is expanded to include conditions related to the use of funds, the following table illustrates how the approach could be applied from the central government perspective.

<b>Steps to apply a performance obligation approach – central government provides funding for dental services provided by a local government health department.</b>	
Step 1 – Identify the contract with the resource recipient.	<ul style="list-style-type: none"> <li>• The grant agreement between the central government and the local government health department creates enforceable rights and obligations.</li> <li>• The contract has been approved by both parties and the payment terms can be identified by both the central government and the local government.</li> <li>• The rights to goods and services <i>to be transferred</i> is not as easily applied in this example, as the grant agreement does not specify any specific goods or services to be provided, only the stipulation that the funds be used in support of the local government providing dental services in general. The model could be expanded to include the stipulation (condition) on use of funds as the performance obligation of the local government. The question that arises is whether the stipulation is sufficiently specific to allow the local government health department to demonstrate satisfaction of the restriction as a performance obligation. If so, the performance obligation model could be applied.</li> </ul> <p>A similar expansion of the model could be considered from the resource provider view. The central government has an enforceable right to expect the local government health department to use the funds as specified in the grant agreement, even though no transfer of goods or services is expected to be made to the central government.</p> <ul style="list-style-type: none"> <li>• The contract has commercial substance and it is probable that the central government will pay the grant to the local government.</li> </ul> <p>The grant agreement could be within the scope of the expanded model.</p>
Step 2 – Identify the performance obligations in the contract.	This contract does not include a promise from the local government to transfer control of the goods or services to the central government. However, there is a performance obligation in that the local government must use the funds to support the provision of dental services or return the funds to the central government.
Step 3 – Determine the transaction price.	The transaction price is the amount of the grant agreement, or CU200,000.
Step 4 – Allocate the transaction price.	In this example, the stipulation to use funds to support provision of dental services is a single performance obligation.

<p>Step 5 – Recognize expense when (or as) a performance obligation is satisfied.</p>	<p>This example involves transfer of control of services to the ultimate beneficiary, not the central government. The criteria to determine the satisfaction of a performance obligation over time or at a point in time would need to be modified from the criteria specified in IFRS 15.35, but could include evaluation of whether the beneficiary simultaneously receives and consumes the benefits provided by the local government’s performance as the local government performs, similar to the current criteria in IFRS 15.35 (c). If that modification is made, as dental services are provided the local government health department satisfies the performance obligation.</p> <p>The central government requires the local government health department to demonstrate satisfaction of the performance obligation through periodic reporting even though control of the dental services is not transferred to the central government.</p> <p>The central government recognizes expense as the dental services are provided.</p> <p>If payment is made immediately, the central government recognizes a decrease in cash. If not, the central government recognizes a liability.</p>
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**Matter(s) for Consideration**

2. The IPSASB is **asked** if it agrees that the performance obligation approach can be used for Category B expense transactions.

**Transactions with Multiple Components**

25. In some Category B transactions, the entity providing consideration may intend for a portion of the consideration to be in exchange for a performance obligation and a portion of the consideration to be a donation, or what is considered a non-exchange transaction in current guidance. Paragraph 10 of IPSAS 23 describes these transactions in the context of exchange and non-exchange components as follows:

There is a further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases, the entity determines whether there is a combination of exchange and non-exchange transactions, each component of which is recognized separately.

26. Paragraph 11 of IPSAS 23 also describes situations in which the sale of goods may be completed at a subsidized price, which may indicate the transaction is non-exchange in nature, or at a discount, which may not mean that the transaction is non-exchange in nature. IPSAS 23 notes that the substance of the transaction should be evaluated using professional judgment.
27. In a performance obligation approach, the portion of the consideration attributed to the performance obligations described in the agreement would be allocated to those performance obligations for recognition purposes. If there is a portion of the consideration that is not considered to be in exchange for goods or services provided, that portion could be considered to be a Category C transaction and should not be allocated to the performance obligations in the contract.

28. Similar to the judgment needed to determine if a transaction includes both exchange and non-exchange components described in the paragraphs of IPSAS 23 referenced above, judgment may be needed to determine if the consideration in a transaction is intended only to be in exchange for the performance obligations in an agreement. From a resource provider or expense view, the entity providing the resources may be able to identify the donation component.
29. For example, a resource provider may agree to provide a total of CU6 million to a resource recipient. The agreement requires the resource recipient to provide goods to the community valued at CU5 million and allows the resource recipient to retain the CU1 million regardless of the goods provided to the community.
30. In this example, the CU5 million could be allocated to the goods to be provided, or the performance obligation, for recognition purposes. The resource provider could recognize expense as the resource recipient provides the goods as specified in the agreement. The CU1 million that is not associated with an obligation of the resource recipient to complete an action could be considered a donation. Because there is no performance obligation associated with the CU1 million, to apply the performance obligation approach, the CU1 million would be included in the amount allocated to the goods to be provided, which would delay recognition of the expense for the resource provider until the resource recipient satisfies the performance obligation. However, the resource recipient is not required to provide goods in order to retain the CU1 million. The resource provider does not have a realistic alternative to avoid the outflow of the CU1 million. The recognition of that portion of the agreement could follow guidance for Category C transactions.

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

3. The IPSASB is **asked** if it agrees that transactions with a donation component should be separated into the performance obligation component and the donation component for recognition purposes.

### **Advantages and Disadvantages of Performance Obligation Approach for Expenses**

31. The advantages of the performance obligation approach described for the recognition of revenue are also applicable to the use of the approach for recognition of expenses. One of these advantages is that the use of the performance obligation model does not require an entity to assess whether a transaction is exchange or non-exchange in nature. Some preparers interviewed noted that the classification of revenue transactions as exchange or non-exchange could be challenging. Use of the performance obligation approach for expenses could avoid that implementation issue.
32. In the examples described above, the recognition of liabilities by a public sector entity that is a customer or resource provider using the performance obligation approach is consistent with the recognition of liabilities in the Conceptual Framework. Although this conceptual consistency is desirable, recognition of liabilities and related expenses using the exchange/non-exchange approach also is expected to be conceptually consistent. Therefore, the conceptual consistency cannot be treated as an advantage of one model over the other.
33. The use of the performance obligation approach also has disadvantages. Entities will need to determine whether their contracts for purchases or payment of resources include performance obligations that meet the definition used in the guidance, either the model based on the IFRS 15 specifications or an expanded approach. This determination will require evaluation of both the specificity and enforceability of the performance obligations. Although the use of the exchange/non-

exchange approach requires judgment that has been challenging, the judgments required for evaluating performance obligations may be no less challenging. The evaluation of performance obligations may be complex for revenue transactions and has not been contemplated for expense transactions in the models of other standard setters.

34. As noted in the introduction, application of the performance obligation model to expenses represents new ground, as the model used in IFRS 15 solely addresses revenue from contracts with customers. Guidance for expenses is not included in that model. To expand the model to revenue transactions that do not fit the same scope as that used in IFRS 15 may be challenging alone. To add the additional expansion of the model to include expenses transactions may not be feasible.
35. Another disadvantage is that the model may be too complex for the types of transactions common for public sector entities that are resource providers. Many interview respondents did not note difficulty in the accounting for non-exchange transactions. Outreach efforts for the expense project focused on non-exchange transactions and did not include questions regarding exchange transactions. Feedback has not been noted that indicates any difficulty in the accounting for exchange transaction. Consequently, the application of the performance obligation model to expenses may be too cumbersome for transactions that have not caused difficulty or complexity for preparers and auditors.

**Matter(s) for Consideration**

4. The IPSASB is **asked** if it agrees with the advantages and disadvantages of application of the performance obligation model to expenses described.
5. The IPSASB is **asked** to identify additional advantages and disadvantages of application of the performance obligation model to expense transactions.

**Meeting:** International Public Sector Accounting Standards Board  
**Meeting Location:** Toronto, Canada  
**Meeting Date:** June 21-24, 2016

**Agenda  
Item  
11.5**

For:  
 Approval  
 Discussion  
 Information

***Revenue and Non-Exchange Expenses  
Consultation Paper – Chapter 2***

**Overview**

Chapter 2 of the Revenue and Expenses Consultation Paper seeks to explore how a performance obligation approach could be applied to improve the accounting for revenue and expense transactions in the public sector.

The Chapter seeks constituent views on whether a performance obligation approach would be appropriate for the development of two approaches for the recognition of revenue and expense transactions arising from arrangements involving the satisfaction of performance obligations. The two approaches are:

- The IFRS 15 performance obligation approach (Category A transactions); and
- The public sector performance obligation approach (Category B transactions).

Under a performance obligation approach for recognition of revenue and expense transactions in the public sector, both approaches above would be used in the development of standard-level requirements. The choice of approach will depend on the nature and substance of the revenue or expense transaction.

To explore the extent to which the performance obligation approach could be applied to public sector transactions, the CP has considered three broad categories of revenue and expense transactions:

Category	Characteristics	Approach
A	Revenue transactions that are within the scope of IFRS 15.	IPSAS standard level requirements and guidance converged with IFRS 15 - The IFRS 15 performance obligation approach.
B	Revenue and expense transactions which involve the satisfaction of performance obligations, but do not necessarily contain all the characteristics of a transaction within the scope of IFRS 15.	IPSAS standard level requirements developed by using IFRS 15 as an appropriate reference point and re-expressing and extending the approach to capture a broader range of public sector revenue transactions - The public sector performance obligation approach
C	Revenue transactions which do not involve the satisfaction of performance obligations.	It is anticipated that a residual standard will be required for these transactions – IPSAS 23 approach.

**Purpose of Agenda Item and Action Requested**

To seek feedback from the IPSASB on the draft Consultation Paper Chapter 2. Specific matters for the consideration of the IPSASB have been highlighted within the draft Chapter, the IPSASB is asked to provide feedback on these Matters for Consideration.

**REVENUE AND EXPENSE CONSULTATION PAPER DRAFT****Performance Obligation Approach****Introduction**

- 2.1 This Chapter discusses the performance obligation approach to developing standard level requirements and guidance for the accounting of revenue and expense transactions within the scope of the CP. The Chapter seeks to explore how a performance obligation approach can be applied to improve the accounting for revenue and expense transactions by public sector entities.
- 2.2 IFRS 15 Revenue from Contracts with Customers, issued by the IASB in May 2014, establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize as performance obligations are satisfied. The scope of IFRS 15 is mainly concerned with the accounting for revenue transactions arising from the delivery of goods and services to customers by private sector entities. This CP describes in a broad sense the principles and guidance within IFRS 15 as a performance obligation approach.

*The performance obligation approach*

- 2.3 The core principle of the IFRS 15 performance obligation approach is the recognition of revenue when control of promised goods or services have been transferred to the customer. Underpinning this principle is the identification of performance obligations in contracts with customers and recognizing revenue when (or as) the entity satisfies a performance obligation.
- 2.4 The performance obligation approach seeks to provide an answer to an often important question arising from the preparation of public sector entity financial statements, in what accounting period should revenue earned and expenses incurred be recognized? This question is of particular importance when revenue and expense transactions are related to the satisfaction of performance obligations. In many instances when an entity is involved in the delivery of goods or services to customers, or procurement of goods or services from suppliers (in a for-profit context), it is generally clear when control of the goods or services have been transferred between parties. Under these circumstances, the timing for recognition of revenue and expenses is generally straightforward.
- 2.5 Revenue and expense transactions in the public sector often involve the satisfaction of performance obligations, but not necessarily the direct transfer of specific goods or services to another party. For public sector entities accounting for revenue and expense transactions which include some form of performance obligation in the form multi-year grants, the delivery of services over a period of time, or arrangements involving multiple deliverables, the question of revenue and expense recognition is often not straightforward. Public sector revenue and expense transactions are often complicated further where there are multiple parties to a transaction, this occurs when one entity provides funding to another entity in return for satisfaction of performance obligations which provide direct benefits to a third party (in the public sector often referred to as the beneficiary of the goods or services). A robust revenue and expense recognition framework developed for the public sector is required to ensure a consistent approach to accounting for public sector revenue and expense transactions with performance obligations in practice.

## Application of a performance obligation approach to public sector transactions

- 2.6 The IPSASB is seeking constituent views on whether it is appropriate to introduce the IFRS 15 performance obligation approach into its Standards to account for revenue transactions in the public sector that are consistent in substance and nature with the intended scope of IFRS 15. These transactions are generally classified as exchange transactions in the current IPSASB literature. For discussion purposes the CP describes these transactions as *Category A* transactions.
- 2.7 The IFRS 15 performance obligation approach provides a comprehensive and robust framework for the recognition of revenue for the private sector entities. The IPSASB considers the new thinking within IFRS 15 provides an appropriate reference point to explore the extent to which a performance obligation approach could be applied to public sector transactions, that were not specifically considered by the IASB in developing IFRS 15.
- 2.8 The IPSASB is also seeking constituent views on whether it is appropriate to consider re-expressing the IFRS 15 performance obligation approach, to allow for the approach to be extended to a broader range of public sector transactions involving the satisfaction of performance obligations. The CP describes the re-expression of the IFRS 15 performance obligation approach, as a *public sector performance obligation approach*.
- 2.9 The public sector performance obligation approach will use IFRS 15 principles and guidance as a reference point for developing the IPSASB's own performance obligation approach. It is anticipated the public sector performance obligation approach will capture a range of exchange and non-exchange transactions (as currently defined by IPSASs). For discussion purposes the CP describes these transactions as *Category B* transactions.
- 2.10 In summary, this CP Chapter considers the application of two broad approaches for the recognition of public sector revenue and expense transactions which require the satisfaction of performance obligations. The two approaches are:
- The IFRS 15 performance obligation approach (Category A transactions); and
  - The public sector performance obligation approach (Category B transactions).
- 2.11 Under a performance obligation approach for recognition of revenue and expense transactions in the public sector, both approaches above would be used in the development of standard-level requirements and made available. The preparer would be required to choose the appropriate approach based on the nature and substance of the revenue or expense transaction.
- 2.12 The performance obligation approach, will not be appropriate for public sector revenue and expense transactions which do not involve the satisfaction of performance obligations. The IPSASB recognizes a separate approach to deal with these transactions will still be required. For discussion purposes the CP describes these transactions as *Category C* transactions.
- 2.13 Under a performance obligation approach it is envisaged that revenue and expense transactions will no longer be initially classified as exchange or non-exchange transactions. Instead revenue and expense transactions will be initially classified based on the existence of performance obligation characteristics for the purpose of determining the appropriate recognition approach.

*Key CP Chapter considerations*

- 2.14 This Chapter is seeking constituent feedback on the extent to which a performance obligation approach could be applied to the revenue and expense transactions undertaken by public sector entities, including:
- The application of a performance obligation converged with IFRS 15, to account for revenue transactions in the public sector that are consistent in substance and nature with the intended scope of IFRS 15;
  - The basis for the development of a public sector performance obligation approach, to allow the approach to be suitable for a broader range of public sector revenue and expense transactions;
  - Whether the performance obligation approach could be applied to some transactions that currently fall within the scope of IPSAS 23; and
  - Clarification of revenue and expense transactions where the performance obligation approach would not be appropriate.

*Outline of chapter*

- 2.15 This Chapter considers the application of a performance obligation approach to revenue and expense transactions in the following chapter sections:
- Reasons for considering a performance obligation approach
  - Overview of the IFRS 15 performance obligation approach
  - Application of a performance obligation approach to public sector revenue transactions
    - The IFRS 15 performance obligation approach (Category A transactions)
    - The public sector performance obligation approach (Category B transactions)
    - Revenue transactions with no performance obligations (Category C transactions)
  - Application of a performance obligation approach to public sector expense transactions
    - The public sector performance obligation approach (Category B transactions)
    - Expense transactions with no performance obligations (Category C transactions)
  - Advantages of the performance obligation approach
  - Disadvantages of the performance obligation approach

## Reasons for considering a performance obligation approach

### *Convergence with IFRS (to the extent appropriate)*

- 2.16 When developing standards, the IPSASB seeks to maintain convergence with IFRS to the extent appropriate for the public sector, with an overarching objective of developing IPSASs consistent with the IPSASB's Conceptual Framework. As a result of the IASB issuing IFRS 15, the IPSASB has considered it appropriate to consider the extent to which a performance obligation approach could be applied to develop standards-level requirements and guidance for revenue and expense transactions in the public sector.

### *The issuance of IFRS 15 provides a reference point to improve current IPSAS guidance*

- 2.17 The IASB's issuance of IFRS 15 and its new performance obligation approach has provided the IPSASB with a reference point to develop its own public sector performance obligation approach to capture a broader range of public sector revenue and expense transactions. An IPSAS based on a performance obligation approach could be used to provide guidance for revenue and expense transactions, specifically where the transaction involves an entity providing resources to another entity in exchange for the satisfaction of performance obligations.

### *Responding to constituent feedback and concerns with current guidance*

- 2.18 The IPSASB has an objective of improving its guidance for the recognition of revenue and expense transaction in response to concerns raised through interviews with constituents, in particular IPSAS 23 applications issues and a need to fill gaps in its current literature in relation to expenses. The IPSASB considers a performance obligation approach could be a reasonable basis for some (but not all) revenue and expense transactions in the public sector, including some transactions that might currently be classified as non-exchange transactions.

### *Consistency with IASB's Conceptual Framework*

- 2.19 The current IPSAS revenue standards pre-date both the current IASB and IPSASB's Conceptual Frameworks. The IPSASB's Conceptual Framework was approved by the IPSAB in September 2014. The current IPSAS revenue standards pre-date the IPSASB's Conceptual Framework and therefore are not consistent with that framework in all respects. A primary reason for the IPSASB undertaking the Revenue and Expense Project is to ensure the principles for revenue and expense recognition within the standards are consistent and guided by the IPSASB's Conceptual Framework.
- 2.20 The IPSASB considers the principles and guidance introduced by IFRS 15 are not fundamentally different from the current IPSAS Standards or IPSASB's Conceptual Framework guidance which addresses the recognition of revenue and expenses. However, IFRS 15 is considered to provide a more robust framework to address what might be regarded as weaknesses in existing requirements and guidance.

## Overview of the IFRS 15 Performance Obligation Approach

### *History of IFRS 15*

- 2.21 In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 sets out the principles and requirements for recognizing revenue from contracts with customers (except for contracts that are within the scope of the Standards on leases, insurance contracts and financial instruments). IFRS 15 is effective for accounting periods beginning on or after 1 January 2018.

- 2.22 The development of IFRS 15 was the result of a IASB joint project with a US national standard-setter, the Financial Accounting Standards Board (FASB). The primary objective of the joint project was to develop a high-quality global accounting standard for revenue recognition. IFRS 15 replaces most of the detailed guidance on revenue recognition that previously existed under US GAAP for nongovernmental entities and IFRS.

#### *Replacement of current IASB revenue standards*

- 2.23 Prior to IFRS 15 the IASB's two main revenue standards were:
- IAS 18, *Revenue* which was originally issued in 1982, and reissued in 1993. IPSAS 9, *Revenue from Exchange Transactions* is based on IAS 18; and
  - IAS 11, *Construction Contracts* which was originally issued in 1979, and reissued in 1993. IPSAS 11, *Construction Contracts* is based on IAS 11.
- 2.24 IFRS 15 supersedes IAS 11, IAS 18 and the following IASB interpretations:
- IFRIC 15, *Agreement for the Construction of Real Estate*;
  - IFRIC 18, *Transfers of Assets from Customers*; and
  - SIC 31, *Revenue-Barter Transactions involving Advertising Services*.
- 2.25 None of the interpretations listed above have been considered by the IPSASB and do not form part of IPSAS 9 and IPSAS 11. However, the principles applied in the interpretations are consistent with the revenue recognition principles within IAS 11 and IAS 18.

#### *Reasons for issuing IFRS 15*

- 2.26 The IASB initiated the project to clarify the principles for recognizing revenue and to develop a revenue standard for IFRS that would:
- Remove inconsistencies and weaknesses in previous revenue requirements, which emerged when applied to specific situations;
  - Provide a more robust framework for revenue recognition, in light of the importance of the revenue number to users of financial statements;
  - Improve comparability of revenue recognition practices;
  - Provide more useful information to users of financial statements through improved disclosure requirements; and
  - Simplify the preparation of financial statements by reducing the number of standard-level requirements to which an entity must refer.
- 2.27 In IFRS, significant diversity in revenue recognition practices had arisen because previous revenue standards contained limited guidance on many important topics, such as accounting for arrangements with multiple elements. Furthermore, the limited guidance that was provided was often difficult to apply to complex transactions, particularly because previous revenue standards did not include any basis for conclusions.

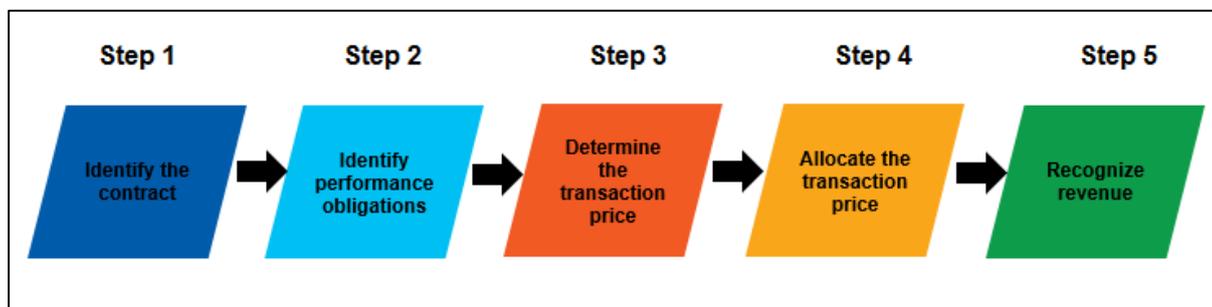
#### *The IFRS 15 Performance Obligation Approach*

- 2.28 The core principles of the IFRS 15 performance obligation approach are:
- Revenue should be recognized to reflect the transfer of control of promised goods or services (performance obligations) to the customer; and

- The amount of revenue recognized should be equal to the consideration that the entity is entitled to for satisfying the performance obligations.
- 2.29 Under IFRS 15 an entity recognizes revenue when (or as) it satisfies performance obligations. The timing of payment does not generally affect the recognition of revenue under IFRS 15. Revenue recognition can occur before or after the entity receives payment, or is entitled to payment. If an entity satisfies the performance obligation before it is entitled to payment it recognizes a contract asset. At the point in time it becomes entitled to payment, it recognizes a receivable.
- 2.30 A underlying principle of the revenue recognition model in IFRS 15 is the concept that revenue is not recognized until control of the promised goods or services are transferred to the customer. We tend to think of the concept of transferring control in a revenue transaction only relates to the sale of goods (described as transferring control of assets). However, the performance obligation approach considers both goods and services are assets (even if only temporarily). Control of services rendered are transferred to the customer when the customer obtains the benefits of those services or the ability to direct the use of those benefits.
- 2.31 Under the performance obligation approach, performance obligations may be satisfied:
- Over time (typically for promises to transfer services to a customer); or
  - At a point in time (typically for promises to transfer goods to a customer).
- 2.32 IFRS 15 allows for the recognition of revenue over time, if one of the following criteria is met:
- The customer simultaneously receives and consumes the benefits provided as the performance obligations are performed;
  - The entity's performance creates or enhances an asset (for example work in progress) that the customer controls as the asset is created or enhanced; or
  - The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right for performance completed to date.
- 2.33 For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.
- 2.34 If an entity does not satisfy the IFRS 15 criteria to recognize revenue over time, revenue is then recognized at a point in time. This can result in revenue not being recognized in a contract delivered over multiple-periods until the promised goods or services are fully completed and control has been transferred to the customer.
- 2.35 When performance obligations are satisfied at a point in time, an entity is required to form a judgement about when control of the goods or services are transferred to the customer. IFRS 15 provides the following indicators for determining the transfer of control at a point in time including (but are not limited to):
- The entity has a present right to payment for the asset;
  - The customer has legal title;
  - The entity has transferred physical possession to the customer;
  - The customer has significant risks and rewards of the ownership of the asset; or
  - The customer has accepted the asset.

2.36 The core principles of the performance obligation approach are explained by means of a five-step revenue recognition model. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to customer at the amount to which the entity expect to be entitled.

2.37 The five-step revenue recognition model:



- (a) **Step 1: Identify the contract with the customer** - a contract is an agreement between two or more parties that creates enforceable rights and obligations.

The scope of IFRS 15 is limited to contracts with customers when all of the following criteria are met:

- the parties to the contract have approved the contract and are committed to perform their respective duties;
- rights to goods and services to be transferred and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is probable.

- (b) **Step 2: Identify the performance obligations in the contract** - these are promises in a contract to transfer goods or services to a customer that are *distinct*.

If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a good or service that is distinct.

- (c) **Step 3: Determine the transaction price** - the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of consideration, but it may sometimes include variable consideration (which requires estimation when highly probable) and non-cash consideration. Discounting for the time value of money may be required.

- (d) **Step 4: Allocate the transaction price to the performance obligations in the contract** - an entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or

service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. This step includes consideration of discounts and variable consideration.

- (e) **Step 5: Recognize revenue when (or as) the entity satisfies the performance obligation** - an entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

2.38 In summary, the main characteristics of a revenue transaction within the scope of IFRS 15 are as follows:

- There has to be a customer who receives the benefits of delivered goods or services, described as satisfaction of performance obligations;
- The performance obligations can be identified;
- The performance obligations are established through a legal contract, which creates enforceable rights and obligations between the parties;
- Control of the promised goods or services is transferred to the customer; and
- The contract has commercial substance.

2.39 In the subsequent sections of this CP Chapter, the application of the characteristics assumed in a IFRS 15 transaction to public sector revenue and expense transactions has been explored, including the re-expression of the performance obligation approach to allow the approach to be applied to a broader range of public sector transactions.

#### **Matters for IPSASB Consideration 1**

Staff and the TBG had mixed views on the level of detail provided within the CP Chapter in relation to - Overview of the IFRS 15 performance obligation approach.

The current level of level detail has been provided for the purpose of:

- Providing the reader with an understanding of the key IFRS 15 characteristics and principles. It is anticipated that some readers may not have a broad understanding of IFRS 15. Given the performance obligation approach is based on the IFRS 15 revenue recognition model, we feel it is important this information is provided upfront in the CP Chapter before exploring how the approach could be applied to public sector transactions.
- Detail of the history of the IFRS 15 project and the post-lease have been provided to illustrate the significant due-process completed by the IASB when developing this standard – supports the notion the IPSASB should consider the performance obligation model for certain revenue and expense transactions.

Alternatives to including the detail on the IFRS 15 performance obligation approach in Chapter 2 is moving some of the detail to either:

- Chapter 1: Introduction; or
- A separate Appendix

1. Does the IPSASB consider the level of detail provided in Chapter 2, Overview of the IFRS 15 performance obligation approach, is appropriate?

## Application of a performance obligation approach to public sector revenue transactions

2.40 To explore the extent to which the performance obligation approach could be applied to public sector transactions, the IPSASB have considered three broad categories of revenue transactions. The categories used in this CP Chapter have been used to assist in describing ideas and principles for the purpose of seeking constituent views on the application of a performance obligation approach to public sector revenue transactions.

Category A: Revenue transactions that are within the scope of IFRS 15. In summary, this category includes exchange transactions involving the transfer of promised goods or services to customers as defined in IFRS 15. The key characteristics of a transaction within this category, is a contract with a customer which establishes clearly identifiable and enforceable performance obligations. It is anticipated the IPSAS approach for revenue transactions within this category will be converged with IFRS 15.

For example, a revenue transaction involving the delivery of contracted professional services by a public sector entity to other public sector entities at market rates. The application of the performance obligation approach to this example is provided in Appendix D.

Category B: Revenue transactions with performance obligations, but do not necessarily contain all the characteristics of a transaction within the scope of IFRS 15. In summary, this category includes a range of exchange and non-exchange transactions (as currently defined by IPSAS standards) with performance obligations. It is anticipated the IPSAS approach for these transactions will be based on an IFRS 15 performance obligation approach, re-expressed for the public sector. This category also includes public sector transactions involving three parties – an entity that enters into an arrangement to provide funding (resource provider), to another entity in return for delivering goods and services (resource recipient) to a third party who receives the direct benefit of those goods or services (resource beneficiary).

For example, a grant from a central government to a local government health organization in exchange for the delivery of a vaccination program to the community. The grant does not cover the full cost of the vaccination program. The application of the performance obligation approach to this example is provided in Appendix D.

Category C: Revenue and expense transactions with no performance obligations. In summary, this category includes non-exchange transactions not within the scope of Category B transactions. It is anticipated that a residual standard will be required for these transactions.

2.41 It is anticipated that the development of a performance obligation approach for Category A and Category B public sector transactions would provide for similar principles in relation to the recognition of revenue. The recognition of revenue under the two performance obligation approaches are summarized as follows:

- *IFRS 15 performance obligation approach (Category A)* - An entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

- *Public sector performance obligation approach (Category B)* - An entity recognizes revenue when (or as) it satisfies agreed performance obligations.

- 2.42 The IPSASB considers that the basis for developing a public sector performance obligation approach should provide an appropriate amount of flexibility to enable the approach to be applied to a broader range of public sector transactions. The public sector performance obligation approach puts less emphasis on the transfer of control of goods or services directly to a customer when determining the point of revenue recognition. Instead, the public sector performance obligation approach focuses on an entity's ability to demonstrate when a performance obligation is satisfied and does not get caught up on whether it's the resource provider (entity providing funding) or the resource recipient (entity receiving funding and accepts responsibility for satisfaction of performance obligations) who transfers control of the goods or services to the beneficiary (party receiving the benefits of performance obligations). A key feature of the public sector performance obligation approach is the funding provided in a revenue transaction is conditional on the satisfaction of agreed performance obligations.
- 2.43 The key difference between the IFRS 15 performance obligation approach (Category A) and the public sector performance obligation approach (Category B), is the transaction characteristics required under each approach. If a transaction does not contain all the characteristics prescribed under each approach, then revenue recognition based on a performance obligation approach will not be considered appropriate. In these circumstances revenue will be recognized in accordance with IPSAS 23 based guidance (Category C transactions).
- 2.44 The characteristics considered appropriate to define the scope of Category A and Category B transactions are explored in the following sections. The following sections also explore the extent to which the application of the performance obligation approach would be as appropriate revenue recognition model for Category A and Category B transactions.

### **The IFRS 15 performance obligation approach (Category A transactions)**

#### *Introduction*

- 2.45 The IPSASB is seeking constituent views on whether standard-level requirements and guidance converged with IFRS 15, will be appropriate for certain public sector revenue transactions, classified as Category A transactions for discussion purposes.
- 2.46 Category A transactions are those transactions that contain all the characteristics of an IFRS 15 performance obligation approach and fall within the scope of IFRS 15. The IPSASB considers that Category A transactions will include the majority of transactions currently classified as exchange transactions and falling within the scope of IPSAS 9 and IPSAS 11.

#### *Need for IPSAS standard-level guidance converged with IFRS 15*

- 2.47 The IPSASB have an objective of convergence with IASB Standards, where appropriate. Therefore, for revenue transactions in the public sector which are similar in nature and substance with for-profit revenue transactions, the IPSASB considers the standard-level requirements and guidance between the IPSASB and IASB should be converged and provide the same outcomes.

#### *Key characteristics of a transaction within the scope of IFRS 15*

- 2.48 The scope of IFRS 15 includes revenue transactions which require the satisfaction of performance obligations and the existence of other characteristics assumed in a private sector for-profit transaction. A transaction is within the scope of IFRS when the following key characteristics are satisfied:

- The scope of the performance obligation approach is limited to revenue transactions;
- The performance obligations are established through a contractual agreement;
- The agreement requires the delivery of goods and services to a customer;
- The rights and obligations in the agreement are enforceable;
- The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined;
- The transaction price can be allocated to the performance obligations in the contract; and
- Revenue is recognized by reference to when (or as) control of the promised goods or services are transferred to the customer.

2.49 If a transaction does not include all the key IFRS 15 characteristics, the performance obligation approach for revenue recognition, is not deemed appropriate for private sector for-profit revenue transactions.

*Development of IPSAS standard-level guidance converged with IFRS 15*

2.50 The development of standards-level requirements and guidance converged with IFRS 15, for the purpose of application to Category A transactions, will require a certain level of modification to allow the approach to be applied to public sector transactions. The IPSASB considers the extent of the modifications will be largely limited to terminology changes. Modifications will be considered at a level consistent with the usual types of modifications expected when developing standards-level guidance converged with IFRS.

2.51 For the purpose of advancing discussions, the IPSASB is seeking constituent view on whether the following modifications would be appropriate for developing IPSAS standard-level guidance converged with IFRS 15:

- Modifying the IFRS 15 definition of revenue to ensure consistency with IPSASB's Conceptual Framework definitions, including the removal of references to "ordinary activities";
- Guidance to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and ownership contributions;
- Widening the concept of transferring control of goods or services to a customer, to include the resource recipient who receives the consideration in exchange for the promise to deliver specific good and services; and
- The rights and obligation are not only established through legal contracts, but can also be established through legal and non-legally binding arrangements; and through legislation or regulation which are enforceable.

### Specific Matters for Comment 1

In your view:

- (a) Do you agree that it is appropriate for IPSAS standard-level requirements and guidance to be developed on a IFRS 15 convergence basis for revenue transactions, which are associated with an arrangement containing all characteristics of an IFRS 15 performance obligation approach?

Please explain the reasons for your views and comments.

### The public sector performance obligation approach (Category B transactions)

#### *Introduction*

- 2.52 This section of the CP Chapter seeks constituent views on whether it is appropriate to develop a public sector performance obligation approach, using the IFRS 15 revenue recognition model as an appropriate reference point.
- 2.53 The objective of this section is to seek constituent feedback on the extent to which the IFRS 15 Performance Obligation Approach could be re-expressed and extended to capture a broader range of public sector revenue transactions, classified as Category B transactions for discussion purposes.
- 2.54 Category B transactions are those transactions that require the satisfaction of performance obligations, but do not necessarily contain all the characteristics assumed in IFRS 15. The IPSASB considers that the scope of a public sector performance obligation approach will include some (but not all) transactions currently classified as non-exchange transactions within the scope of IPSAS 23.

#### *Need for a public sector performance obligation approach*

- 2.55 The performance obligation approach in IFRS 15 was developed for contractual based exchange transactions where goods and services are delivered to customers in order to generate profits. The re-expression and extension of a performance obligation approach in a public sector environment, provides for a number of challenges when applied to public sector transactions which do not contain all the characteristics assumed in a transaction, for which IFRS 15 was developed. Public sector entities primarily receive revenue in exchange for the satisfaction of performance obligations which benefit the public.
- 2.56 In a public sector revenue transaction, in contrast to a private sector for-profit transaction, there may be:
- Less detail on the specifications of the goods or services to be supplied;
  - Three parties involved instead of one supplier and one customer. Entities may receive funding from one party to provide goods or services to another party - resource provider, resource recipient and resource beneficiary;
  - Difficulties determining when there has been a transfer of control of good and services to another entity. Entities may receive a general grant and agree to carry out activities, with a broad objective to benefit the public; and
  - More uncertainty about enforceability. This may be because the agreements do not take the form of a legal contract, there is less detail in the agreement in regards to enforcement mechanisms, or because the parties do not normally take legal action to enforce the agreement.

2.57 Due to inherent differences between public sector transactions and private sector for-profit transactions, the IPSASB considers another approach is required to capture a broader range of public sector transactions with some form of performance obligations.

*Key characteristics of a transaction within the scope of a public sector performance obligation approach*

2.58 The IPSASB is seeking constituent views on whether a public sector performance obligation approach will be appropriate when the resource recipient (entity who receives funding in exchange for the satisfaction of performance obligations) can satisfy all of the following characteristics:

- The transaction is defined as a revenue transactions involving the satisfaction of performance obligations;
- The performance obligations are established through legal and non-legally binding arrangements;
- The arrangement requires the satisfaction of performance obligations, which benefits either:
  - The resource provider (party providing the consideration or funding) directly through the satisfaction of agreed performance obligations; or
  - The intended beneficiaries of the performance obligations, as specified by the resource provider;
- The agreed performance obligations within an arrangement are enforceable;
- The agreed performance obligations within an arrangement are identifiable and specific;
- The funding (or consideration) provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation;
- The funding provided for in an arrangement in exchange for the satisfaction of performance obligations:
  - Has been determined by giving consideration to the nature, cost, value or volume of the promised performance obligations; and
  - Is conditional on the satisfaction of agreed performance obligations; and
- Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligations.

2.59 Each of these characteristics and the basis for their development are discussed further in the following sections.

2.60 If any of these key characteristics are not met for a revenue transaction, then the IPSASB considers the public sector performance obligation approach will not be an appropriate model for the recognition of revenue. In these circumstances revenue will be recognized in accordance with IPSAS 23 based guidance (Category C transactions).

*Development of a public sector performance obligation approach*

2.61 The IPSASB considers the IFRS 15 revenue recognition model is an appropriate reference point to explore the extent to which a performance obligation approach could be developed for public sector revenue transactions involving the satisfaction of performance.

- 2.62 The basis for developing a public sector performance obligation approach has been explored by considering the extent to which the key characteristics assumed in a IFRS 15 transaction could be re-expressed and extended to capture a broader range of public sector transactions.
- 2.63 The re-expression and extension of the key characteristics assumed in a IFRS 15 transaction are considered an appropriate basis for developing the IPSASB's own public sector performance obligation approach.
- 2.64 The development of a public sector performance obligation approach below, have been considered from the perspective of the resource recipient. The resource recipient is the party in an arrangement who has agreed to satisfy agreed performance obligations in exchange for an agreed amount of funding (or technical referred to as consideration in a revenue transaction) from the resource provider.

*Re-expression of IFRS 15 performance obligation characteristics for the purpose of developing a public sector performance obligation approach*

- 2.65 The key characteristics of the IFRS 15 performance obligation approach have been considered below and have been re-expressed for the public sector. The IPSASB have considered the extent to which each characteristic could be re-expressed for the purpose of developing a public sector performance obligation approach. The IPSASB are seeking feedback on whether the re-expressions below are appropriate and will meet the objective of allowing a performance obligation approach to be applied to a broader range of public sector revenue transactions.
- 2.66 When considering whether a public sector revenue transaction will be within the scope of a public sector performance obligation approach, the characteristics should not be considered independently, instead all re-expressed characteristics are required to be considered together (refer to paragraph 2.58).
- 2.67 For each characteristic considered below, a table is provided comparing the performance obligation approach under IFRS 15 to the re-expressed public sector performance obligation approach. The development of a public sector performance obligation approach for Category B transactions is not a convergence project. The comparison tables have been provided to illustrate the extent to which the IFRS 15 characteristics could be expressed to better reflect the nature and substance of public sector transactions involving the satisfaction of performance obligations.
- (a) The transaction is defined as a revenue transaction involving the satisfaction of performance obligations
- 2.68 The scope of IFRS 15 is limited to *revenue* transactions, defined as “*income arising in the course of entity's ordinary activities*”. The current IPSASB literature does not generally make a distinction between ordinary activities and activities outside the ordinary course of operations.
- 2.69 The IASB uses the term income as an overall term and revenue as a subset of income. The definitions of income and revenue as provided for in IFRS 15 Appendix A, reflect this distinction.

*Revenue: Income arising in the course of an entity's ordinary activities.*

*Income: Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.*

2.70 The IPSASB's Conceptual Framework does not distinguish between ordinary activities and activities outside the ordinary course of activities, and defines revenue as:

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

2.71 Public sector entities are often engaged in a wide variety of activities and therefore the IPSASB considers it appropriate to remove any reference to "ordinary activities" from a public sector performance obligation approach. The re-expression of the definition of revenue from that used in IFRS 15, will allow the approach to be extended to a broader range of public sector transactions.

2.72 When developing standard-level requirements for revenue transactions under a performance obligation approach, guidance will be provided to assist users to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and inflows related to ownership contributions.

2.73 Table 1: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
The transaction is defined as a revenue transaction involving the satisfaction of performance obligations	
<b>IFRS 15 Performance Obligation Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The scope of includes only <i>revenue</i> transactions.</p> <p>Revenue: Income arising in the course of an entity's ordinary <i>activities</i></p>	<p>The scope includes revenue transactions as defined by the IPSASB's Conceptual Framework:</p> <p>Revenue: Increases in the net financial position of the entity, other than increases arising from ownership contributions.</p> <p>The approach will be amended to remove any references to ordinary activities.</p> <p>Additional guidance provided to distinguish between revenue transactions and ownership contributions.</p> <p>The scope of the approach will include revenue transactions arising from the satisfaction of performance obligations and will not include other gains arising from the disposal of assets or the recognition of asset fair value movements for example.</p>

- (b) The performance obligations are established through legal and non-legally binding arrangements
- 2.74 The scope of the IFRS 15 performance obligation approach does not include all revenue transactions, but instead is only intended to be applied revenue arrangements where the associated rights and obligations are established by legally enforceable contracts with customers. The IPSASs typically refer to binding arrangements rather than legal contracts because public sector entities do not always have the legal authority to enter into legal contracts.
- 2.75 The IPSASB considers it appropriate the scope of the performance obligation approach, which focuses on contracts with customers, be re-expressed to include revenue transactions with performance obligations established through enforceable legislation and other legal and non-legally binding arrangements that give rise to liabilities. The IPSASBs Conceptual Framework includes both legal and non-legally binding arrangements when discussing the concept of a present obligation for the purpose of defining a liability.
- 2.76 To extend the performance obligation approach to broader range of public sector transactions, the IPSASB considers it appropriate to re-express the scope to include performance obligations, where those performance obligations are established through legislation or regulation.
- 2.77 When identifying a contract, IFRS 15 assumes the customer when entering into a contract has an ability and intention to pay the consideration when due. This cannot be always assumed in the public sector and additional guidance may be needed. Additional guidance is required for arrangements where the activities associated with the delivery of performance obligations commences before funding amounts have been confirmed.
- 2.78 Table 2: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance Obligation Approach Characteristic:</b>	
The performance obligations are established through legal and non-legally binding arrangements	
<b>IFRS 15 Performance Obligation Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>IFRS 15 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations.</p> <p>IFRS 15.9 further defines the characteristics of a contract within scope:</p> <ul style="list-style-type: none"> <li>The parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practice) and are committed to perform their respective obligations;</li> </ul>	<p>The rights and obligations in a transaction involving the satisfaction of performance obligations, which are identifiable and enforceable, are established by an agreement between two or more parties.</p> <p>The agreement could take the form of a:</p> <ul style="list-style-type: none"> <li>Legal and non-legally binding arrangements (as defined by the IPSASB Conceptual Framework 5.15); or</li> <li>Performance obligations established by legislation or regulation, which are identifiable and enforceable.</li> </ul>

<ul style="list-style-type: none"> <li>• The entity can identify each party's rights and obligations regarding the goods and services to be transferred;</li> <li>• The entity can identify the payment terms for the goods or services to be transferred;</li> <li>• The contract has commercial substance; and</li> <li>• It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.</li> </ul>	<p>The intention is to include within the scope a broader range of arrangements that establish rights and obligations that meet the IPSASB Conceptual Framework definition of a liability.</p> <p>A key criterion of an agreement within scope is whether the agreement is enforceable by an another party and performance obligations are identifiable and specific. Both the concepts of enforceability and identifiability, are discussed further below.</p> <p>Additional guidance will be provided for arrangements where the activities associated with the delivery of performance obligations commences before funding amounts have been confirmed or where it is not probable that funding will be received.</p>
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(c) The arrangement requires the satisfaction of performance obligations, which benefits either the resource provider or resource beneficiary

*IFRS 15 characteristic*

2.79 IFRS 15 requires the identification of the customer in each contractual arrangement, this is important because the performance obligation is built on the principle that revenue is not recognized until control of promised goods or services is transferred to the customer.

*Performance obligation characteristic re-expressed for the public sector*

2.80 The nature of revenue transactions in the public sector often precludes the identification of a specific customer. The goods and services provided by public sector entities are often determined by their legislative mandate are provided to a wide range of people and entities. These goods and services are also often provided collectively rather than individually. The specific direct recipients of these goods and services and the portion of the service provided to individual recipients cannot always be identified.

2.81 Public sector transactions often involve three parties, the resource provider who provides the consideration, the resource recipient who receives the consideration and is responsible for the delivery of specific goods or services, and the resource beneficiary of those goods or services, which can include individuals or the wider public. The resource provider in the public sector will often not receive the direct benefit of satisfied performance obligation provided in exchange for agreed consideration (funding). However, in the public sector the resource provider is often viewed as receiving the benefits of satisfied performance obligations delivered to third parties (beneficiaries), when they have an ability to direct who receives the benefits of those performance obligations.

2.82 The IPSASB consider a public sector performance obligation approach will be appropriate when either the resource provider or the agreed beneficiary receives the benefits of agreed performance obligations being satisfied. The performance obligation approach will be appropriate for arrangements involving three parties (resource provider, resource recipient, and resource beneficiary) when:

- Performance obligations have been clearly specified; and
- The intended beneficiaries of those performance obligations has been clearly specified.

2.83 Table 3: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
The agreement requires the satisfaction of performance obligations, which benefits either the resource provider or the intended beneficiaries as specified by the resource provider.	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The contractual arrangement requires the delivery of goods or services to a customer.</p> <p>A customer is defined as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.</p>	<p>The arrangement requires the satisfaction of performance obligations, that are an output of the entity's ordinary activities, which either benefit the:</p> <ul style="list-style-type: none"> <li>• Resource provider (funder) directly through the delivery of goods or services; or</li> <li>• Intended beneficiaries of agreed performance obligations, as specified by the resource provider.</li> </ul>

(d) The agreed performance obligations in the arrangement are enforceable

*IFRS 15 characteristic*

2.84 A key characteristic of the IFRS 15 performance obligation approach is the expectation that performance obligations in contracts are enforceable and the expectation that rights and obligations in contracts will and can be enforced. Contract enforceability in a for-profit context is typically based on the commercial law in each jurisdiction.

2.85 IFRS 15 provides that a performance obligation approach is only appropriate for agreements between two or more parties that create enforceable rights and obligations. Without the existence of enforceable rights and obligations, the definition of a liability may not be satisfied, because under this scenario it will be difficult to demonstrate the existence of a present obligation that cannot be realistically avoided.

- 2.86 IFRS 15, paragraph 10 provides guidance on when rights and obligations in an agreement are enforceable:

*A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.*

*Performance obligation characteristic re-expressed for the public sector*

- 2.87 The IPSASB considers it appropriate for the enforceability requirement to remain under a public sector performance obligation approach. A key principle underpinning the performance obligation approach is the recognition of a liability when consideration (funding) has been received, but associated promised performance obligations have not yet been delivered. Under a public sector performance obligation approach, revenue agreements will only be within scope when they are enforceable, by giving consideration to the IPSASB's Conceptual Framework definition of a liability. For public sector transactions additional guidance will be needed to determine when an arrangement will be defined as enforceable.

- 2.88 To extend the performance obligation approach to broader range of public sector transactions, the IPSASB consider it appropriate the definition of enforceability be extended to include rights and obligations established through "legal or equivalent means". The IPSASB's Conceptual Framework uses the term "legal or equivalent means" within the Basis for Conclusions, paragraph BC5.31:

*Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means.*

- 2.89 The extended definition of enforceability under the public sector performance obligation approach would include legal and non-legally binding arrangements, this approach is consistent with IPSASB's Conceptual Framework, Basis for Conclusions, paragraph BC5.33:

*On balance, the IPSASB agrees with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law.*

- 2.90 In a public sector, a non-legally binding agreement will be considered enforceable when:
- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
  - As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
  - The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

This criterion has been sourced from the IPSASB's Conceptual Framework, paragraph 5.23.

2.91 For constructive obligations to be enforceable by “equivalent means” requires the presence of mechanisms outside the legal system that establish an external party’s right to call upon an entity to act in a particular way thereby leaving that entity with little, if any, discretion to avoid settling a performance obligation. There are a variety of mechanisms in which public sector entities can enforce performance obligations in agreements with other parties. These depend on the legal system in place in a jurisdiction and the types of agreements the public sector entities can enter into.

2.92 The enforcement of agreed performance obligations in the public sector can include using the:

- Remedies set out in the binding agreement (for example, penalties for late delivery or non-performance);
- Remedies available under contract law and consumer protection law that applies to public sector entities (for example, the right and ability to demand return of funding for non-performance);
- Negative impact on an entity’s reputation from non-performance (for example, public disclosure of non-performance); and
- Ability to make an entity aware that, if it does not meet its obligations under a revenue arrangement, it risks not having a future funding relationship.

Additional guidance will be required to clarify the types of legal and non-legal mechanisms considered appropriate for a public sector performance obligation approach.

2.93 In summary, the concept of enforceability under a public sector performance obligation approach will be established through legal or equivalent means. The extension of the definition of enforceability will introduce a greater degree of judgement when compared to IFRS 15, which takes a purely legal approach to defining enforceability. Ultimately for each revenue arrangement an entity will need to consider if performance obligations are enforceable, based on an assessment of whether an agreed performance obligation establishes a present obligation, which an entity has little or no realistic alternative to avoid.

2.94 Table 4: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
<b>The agreed performance obligations in the arrangement are enforceable</b>	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
The enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity’s customary business practice, published policies or specific statements.	Enforceability of rights and obligations in an arrangement are established through legal or equivalent means (i.e. legal and non-legally binding arrangements). An agreement is enforceable by another party through legal or equivalent means if: <ul style="list-style-type: none"> <li>• The resource provider providing the consideration (funding), has through an agreement established the right to</li> </ul>

	<p>enforce specific performance obligations;                  or</p> <ul style="list-style-type: none"> <li>• A mechanism exists to provide the resource provider with legal authority to require the entity to either satisfy the performance obligation or compensate it for not satisfying agreed performance obligations; or</li> <li>• A mechanism outside the legal system that establishes the right of a separate party to require the entity to act in a particular way or be subject to consequences.</li> </ul> <p>Defining arrangements where the resource provider has the ability to enforce the satisfaction of agreed performance obligations will require an assessment of the resource provider's past business practices. For example; when funding is provided in exchange for the satisfaction of performance obligations and those performance obligations are not satisfied, can the resource provider demonstrate a past practice of enforcing the return of funding or imposing other forms of penalties?</p>
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(e) The agreed performance obligations within an arrangement are identifiable and specific

*IFRS 15 characteristic*

- 2.95 IFRS 15 provides that a performance obligation approach is only appropriate when, a contract explicitly states the goods or services an entity has promised to transfer to a customer. Performance obligations can only be enforced when each party has agreed to the promised goods or services to be delivered.
- 2.96 IFRS 15 requires the identification of performance obligations, to enable the determination of when a performance obligation has been satisfied. A performance obligation is defined as a good or service in a contract with a customer that is "distinct". If a promised good or service within the agreement is not distinct it is combined with other promised goods or services until a bundle of goods or services is identified that are distinct.
- 2.97 The objective of identifying each distinct performance obligation within a contract with a customer is to determine whether an entity's promise to transfer that good or service is separately identifiable from other promises in the contract, and should therefore be accounted for separately.

*Performance obligation characteristic re-expressed for the public sector*

- 2.98 The IPSASB considers a public sector performance obligation approach will be appropriate for arrangement that allow for each specific performance obligation to be identified. Under a public sector performance obligation approach, the IFRS 15 description of "distinct goods or

services” could be replaced with “specific and identifiable performance obligations”. The change in terminology reflects the view that the preciseness of promises to transfer goods or services in a for-profit context under IFRS 15, can be quite different than the agreed satisfaction of agreed performance obligations in the public sector.

- 2.99 Determining when a performance obligation is specific and identifiable will often require a greater level of judgement in the public sector, in comparison to private sector for-profit transactions. Appendix D of the CP presents the example of a central government providing a grant to a local government health provider to support the provision of dental services. The arrangement does not clearly specify the goods or services to be purchased or delivered. In this scenario the IPSASB considers a public sector performance obligation approach could be appropriate, when the performance obligations are identifiable and specific.
- 2.100 In the example above, a key indicator of whether there are separate performance obligations in the arrangement which are identifiable, is whether the resource recipient (entity receiving funding and accepts responsibility for satisfaction of performance obligations) can demonstrate the satisfaction of separate performance obligations within the arrangement. The resource recipient could demonstrate satisfaction of performance obligations, by providing evidence of the costs incurred delivering dental services to the public.
- 2.101 In contrast, when for example a central government provides funding to another public sector entity to support the continuance of general operations, a public sector performance obligation approach may not be appropriate due to there being no specific performance obligations or restrictions over the use of funds. In substance, there are no separate or identifiable specific performance obligations within the arrangement, because all funding provided could be spent immediately or deferred to support future operating costs.
- 2.102 Under a public sector performance obligation approach, if the performance obligations within an arrangement are not specific and identifiable, the resource recipient will be required to combine agreed performance obligations until it has identified a bundle of performance obligations that are specific and identifiable. Additional guidance on determining when a performance obligation is identifiable and specific is provided in the summary table below.
- 2.103 The identification of separate performance obligations in an arrangement directly impacts when revenue is recognized. Under a performance obligation approach revenue is generally not recognized until the separate performance obligation has been satisfied, therefore the bundling of agreed performance obligations will often result in a deferral of revenue recognition.
- 2.104 Table 5: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
<b>The agreed performance obligations within an arrangement are identifiable and specific</b>	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>To qualify as a performance obligation, the entity's promise to transfer goods or services in a contract with a customer must be <i>distinct</i>.</p> <p>A good or service that is promised to a customer is distinct if both the following criteria are met:</p> <ul style="list-style-type: none"> <li>• The customer can benefit from the good or service on its own or together with other resources that are readily available; and</li> <li>• The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.</li> </ul> <p>If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identified a bundle of goods or services that is distinct.</p>	<p>To qualify as a performance obligation, an entity's promise to satisfy agreed performance obligations in an enforceable arrangement with a resource provider must be identifiable and specific.</p> <p>The agreement must provide specific information regarding the nature, cost, value or volume of the agreed performance obligations, that allow for each performance obligations to be separately identifiable.</p> <p>A performance obligation will be defined as identifiable and specific when:</p> <ul style="list-style-type: none"> <li>• The performance obligation is separately identifiable from other performance obligations within the arrangement;</li> <li>• The resource recipient can determine when the performance obligation has been satisfied; and</li> <li>• The resource recipient can demonstrate to the resource provider the performance obligation has been satisfied.</li> </ul> <p>If the performance obligations within an arrangement are not specific and identifiable, the resource recipient will be required to combine agreed performance obligations until it has identified a bundle of performance obligations that are specific and identifiable.</p>

## Matters for IPSASB Consideration 2

The CP considers a public performance obligation approach is only appropriate when agreed performance obligations within an arrangement are “identifiable and specific”.

The main criteria for determining when a performance obligation is identifiable and specific is whether the resource recipient has both the ability to determine when a separate performance obligation has been satisfied and an ability to demonstrate to the resource provider the performance obligation has been satisfied.

1. Does the IPSASB agree with the use of the term identifiable and specific?
2. Does the IPSASB agree with the criteria for determining when a performance obligation is defined as identifiable and specific (as provided for in the summary table), is the criteria too restrictive or additional guidance recommended?

Please provide suggestions for any amendments.

- (f) The funding provided for in the arrangement has been determined by giving consideration to the agreed performance obligations, and funding is conditional on the delivery of agreed performance obligations.

### *IFRS 15 characteristic*

2.105 The performance obligation approach within IFRS 15 has been developed for private sector for-profit transactions, where it is assumed that a contract with a customer to deliver promised goods or services has commercial substance. The reference to commercial substance within IFRS 15 is used to describe two characteristics assumed in a contract to deliver promised goods or services to a customer:

- The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered; and
- The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services.

### *Performance obligation characteristic re-expressed for the public sector*

2.106 Both of these characteristics, which are assumed in a private sector for-profit transaction, are not always applicable to public sector transactions involving the satisfaction of performance obligations. Therefore, the IPSASB has considered how these characteristics could be re-expressed for a public sector performance obligation approach.

- (i) *The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered*

2.107 The IPSASB considers it appropriate that the public sector performance obligation approach continues to be applicable to arrangements where the amount of funding is determined by the resource provider giving consideration to the level of agreed goods and services to be delivered. Under the public sector performance obligation approach, this characteristic could be described as an arrangement where it can be demonstrated the amount of funding provided has been determined by the resource provider (the funder) by giving consideration to the nature, cost, value or volume of the agreed performance obligations. In general terms, to apply a public sector performance obligation approach, an entity will need to demonstrate a linkage between the amount of agreed funding and the agreed performance obligations.

- 2.108 An indicator of whether a linkage between the amount of agreed funding and the agreed performance obligations can be demonstrated, will be whether the arrangement provides for the amendment of funding levels when agreed performance obligations are either under or provided.
- 2.109 Another indicator of a linkage between the amount of agreed funding and the agreed performance obligations, is arrangements where the amount of funding is conditional on the satisfaction of agreed performance obligations. If funding is provided with no consequence for under or over delivery of performance obligations, then the IPSASB considers the performance obligation approach will not be an appropriate revenue recognition model for these transactions.
- 2.110 Where there is no linkage between the agreed funding and the agreed performance obligations, it would be difficult to demonstrate the agreed performance obligations are enforceable, because there are effectively no financial consequences for non-performance. Under this scenario, the public sector performance obligation approach may not be an appropriate revenue recognition model.
- (ii) *The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services*
- 2.111 In the private sector it is assumed the amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services, this is due to commercial arrangements being entered into between a willing buyer and a willing seller.
- 2.112 In public sector arrangements where performance obligations are expected to be delivered in exchange for funding received from another entity, it cannot be assumed the amount of funding received will be approximately equal to the value of the agreed performance obligations.
- 2.113 Public sector entities often provide subsidized services, for example a swimming pool owned and operated by a local government entity will receive funding from central government to subsidize the cost of providing swimming facilities and the remaining costs are recovered from pool entrance fees earned from the public. In these circumstances it can be difficult in practice to determine if each party providing funding to the local government entity is receiving services which are considered to be of approximately equal value to the funding (or entrance fees) exchanged.
- 2.114 The concept of determining when a revenue transaction involves one entity receiving assets or services in exchange for funding of approximately equal value, is currently a concept within IPSAS 23, used when classifying transactions as either exchange or non-exchange. The exchange of approximately equal value between two or more parties may not be a characteristic of all public sector transactions involving the satisfaction of performance obligations. This is due to public sector transactions often occurring on non-market terms, therefore determining when a transaction involves the exchange of approximately equal value requires a significant amount of judgement.
- 2.115 The IPSASB when developing a public sector performance obligation approach considered it appropriate to put less emphasis on the need for an arrangement to demonstrate an exchange of approximately equal value. Instead, the public sector performance obligation approach will place greater emphasis on the need for an arrangement to demonstrate the amount of funding has been determined by giving consideration to the agreed performance obligations and demonstrating the funding is conditional on the satisfaction of the performance obligations.

2.116 Table 6: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

Performance obligation approach characteristic:	
The funding provided for in the arrangement has been determined by giving consideration to agreed performance obligations, and funding is conditional on the delivery of agreed performance obligations.	
IFRS 15 Performance Approach	Public Sector Performance Obligation Approach
The scope includes contracts which have commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract).	<p>An arrangement within the scope, will be required to demonstrate a linkage between the funding provided to another entity and the agreed performance obligations.</p> <p>The scope of the public sector performance obligation approach is limited to arrangements where the amount of funding:</p> <ul style="list-style-type: none"> <li>○ Has been determined by giving consideration to the nature, cost, value or volume of the promised goods and services to be delivered; and</li> <li>○ Is conditional on the delivery of promised goods or services.</li> </ul>

### Matters for IPSASB Consideration 3

IFRS 15 considers a performance obligation approach is only appropriate when an arrangement is considered to have commercial substance.

Staff had mixed views on how to re-express the IFRS 15 concept of commercial substance for the public sector.

Alternative approaches considered:

- This characteristic could be removed in its entirety as a criterion for applying a public sector performance obligation approach, the most important criterion is an arrangement where funding has been provided in exchange for the satisfaction of performance obligations. This is adequately addressed by other characteristics included in the public sector performance obligation approach, within the CP.
- New Zealand Treasury 2013 Guidance on recognising liabilities and expenses, allows for a performance obligation when “the value of services is approximately equal to the funding”.
- Other jurisdictions have taken the view that a performance obligation approach is appropriate when:

An arrangement demonstrates a correlation between the nature, cost or volume of the promised goods or services and the consideration an entity expects to receive in exchange for satisfaction of those performance obligations. If the consideration provided is unrealistic in relation to the cost

of delivering the promised goods or services, then this would be an indicator a performance obligation approach may not be appropriate.

In the draft CP Chapter, we have taken the view that including within a performance obligation approach a criterion to demonstrate the value of services is approximately equal to the funding, would be too restrictive and would not achieve the objective of developing a performance obligation approach appropriate for a broad range of public sector transactions with performance obligations.

1. Does the IPSASB agree with the approach taken in the CP, or would you suggest other views be expressed?

- (g) The funding provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation

*IFRS 15 characteristic*

- 2.117 IFRS 15 defines the total amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer as the “transaction price”. The allocation of the transaction price to each performance obligation within a contract is a critical step in the revenue recognition model, because this step directly impacts how much revenue will be recognized when (or as) performance obligations are satisfied.
- 2.118 IFRS 15 requires the transaction price to be allocated to each performance obligation (each distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. The transaction price is allocated to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or service. If a stand-alone selling price is not observable, an entity is required to estimate it. IFRS 15 provides examples of methodologies an entity could choose to use to determine or estimate the stand-alone selling price.

*Performance obligation characteristic re-expressed for the public sector*

- 2.119 Within the public sector, goods and services do not always have stand-alone selling prices, due to the integrated nature of the goods and services provided. Many public sector entities do not compete directly with private sector entities and may not price goods or services based on market considerations. Many public sector entities receive funding from the central government in exchange for the satisfaction of performance obligations, which involve the delivery of goods or services to the public. For example; funding from the central government to other public sector entities to deliver education and health care services to the public. Under these arrangements it can be difficult to determine the stand-alone selling price of each identifiable and specific performance obligation within the funding arrangement.
- 2.120 Under the public sector performance obligation approach, the IPSASB consider it appropriate to place less emphasis on the need to determine the “stand-alone selling price” and instead focus on an entity’s ability to determine the “cost of delivery” for each identifiable and specific performance obligation, as a basis for allocating the total amount of agreed funding to each performance obligation.
- 2.121 If the allocation of the total amount of agreed funding to each identifiable and specific performance obligation cannot be estimated reliably on a cost of delivery basis, this would indicate that it may not be appropriate to account for the arrangement in accordance with the public sector performance obligation approach.

*Donation component*

- 2.122 When allocating the total amount of agreed funding (consideration) in an arrangement, under a public sector performance obligation approach, the first step required is the identification of any separately identifiable funding amounts not related to the satisfaction of agreed performance obligations.
- 2.123 The amount of agreed funding not attributable to the satisfaction of performance obligations within an arrangement should be accounted for separately, referred to as a donation component. If a revenue transaction includes an identifiable donation component this should be excluded from the funding balance allocated across the performance obligations, and recognized as revenue in accordance with the residual revenue guidance for Category C transactions.
- 2.124 The IPSASB considers the following indicators could be used to provide evidence that a component of the revenue funding is separately identifiable from the funding provided in exchange for satisfaction of performance obligations:
- The customer or resource provider makes the entity aware that there was intended to be a donation component in the arrangement;
  - The entity's entitlement to retain the donation is not conditional on the satisfaction of performance obligations; and
  - The amount of the donation component allocated to the non-exchange component can be separately identified and measured reliably.
- 2.125 Where both the existence and amount of the donation component is not readily apparent, then the entire amount of funding is included in the agreed funding balance allocated across performance obligations.
- 2.126 Table 7: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
<b>The funding (or consideration) provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation</b>	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
<p>The entity shall allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.</p> <p>To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone basis.</p>	<p>The entity shall allocate the total amount of funding to each identifiable and specific performance obligation in an amount that depicts the amount of funding (consideration) to which the entity expects to be entitled in exchange for satisfaction of the performance obligation.</p> <p>To meet the allocation objective, an entity shall allocate the total amount of agreed funding to each identifiable and specific performance obligation identified in the arrangement on an estimated cost of delivery basis.</p>

	<p>The resource recipient will need to demonstrate it can estimate the cost of delivering each identifiable and specific performance reliably.</p> <p>If a revenue transaction includes an identifiable donation component this should be excluded from the total amount of funding allocated across performance obligations, and recognized as revenue in accordance with the residual revenue standard for Category C transactions.</p>
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#### **Matters for IPSASB Consideration 4**

Replacing the basis of allocating the total amount of funding in a revenue transaction from a IFRS 15 “stand-alone selling price” basis to a re-expressed public sector basis of the estimated “cost of delivery” for each identifiable and specific performance obligation is a new concept that has not been previously discussed with the IPSASB.

The cost of delivery basis for allocating the total amount of agreed funding is similar to the “stage of completion” method currently provided for under IPSAS 9.

1. Does the IPSASB agree the “cost of delivery” is an appropriate method for allocating the total amount of funding across identifiable and specific performance obligation? Should the CP explore further other options?  
  
If yes, what options would you suggest?

- (h) Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligation

#### *IFRS 15 characteristic*

- 2.127 Under the IFRS 15 revenue recognition model an entity satisfies performance obligations when (or as) the promised goods or services (described as assets) are transferred to the customer. An asset is transferred when (or as) the customer obtains control of that asset. Revenue is recognized when (or as) control of the promised goods or services are transferred to the customer.

#### *Performance obligation characteristic re-expressed for the public sector*

- 2.128 Public sector revenue transactions often include performance obligations in the form of a promises to complete certain activities to support the delivery of goods or services to the public (resource beneficiaries). In these transactions there is often no direct transfer of control of promised goods or services to the party providing the source of funding (resource provider) or to specific individuals in the public.
- 2.129 Under a public sector performance obligation approach, the IPSASB consider it appropriate to re-express the trigger for revenue recognition from when (or as) the entity “transfers control of a good or service” to when (or as) the resource recipient “satisfies the promised

performance obligation”. Although IFRS 15 requires an assessment of when control of an asset is transferred to a customer, the underlying principle is the determination of when performance obligations have been satisfied.

- 2.130 The recognition of revenue as performance obligations are satisfied relies on the ability of the resource recipient (the entity who receives the funding and accepts responsibility for satisfaction of performance obligations) to demonstrate to the resource provider that it has satisfied a performance obligation. This principle is of particular importance in arrangements where the wider public receive the benefits of satisfied performance obligation, rather than the resource provider directly. This outcome will be applicable to many public sector resource providers, given the primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of citizens and other eligible residents.
- 2.131 Demonstrating the satisfaction of performance obligations could be evidenced by reporting on progress to the resource provider. This might be a single progress report (for a performance obligation satisfied at a point in time) or a series of progress reports (for a performance obligation satisfied over time). Reporting on performance obligation progress as a function on its own will not trigger the recognition of revenue, but will be used to provide appropriate evidence and support that identifiable and specific performance obligations have been satisfied.
- 2.132 Under a public sector performance obligation approach, the timing of cash flows between the resource provider and resource recipient will not affect the pattern of revenue recognition. Revenue will be recognized when (or as) performance obligations are satisfied. If consideration for delivery of promised goods or services is received in advance of satisfying the performance obligation, then this will give rise to a liability.
- 2.133 Table 8: Summary of IFRS 15 performance obligation approach characteristic and corresponding re-expression of the characteristic under a public sector performance obligation approach.

<b>Performance obligation approach characteristic:</b>	
Revenue is recognized by reference to when (or as) the resource recipient satisfies the performance obligation	
<b>IFRS 15 Performance Approach</b>	<b>Public Sector Performance Obligation Approach</b>
An entity recognizes revenue when (or as) it satisfies performance obligations, which is when control of the promised goods or services are transferred to the customer.	A resource recipient recognizes revenue when (or as) it satisfies each identifiable and specific performance obligations; this will occur when: <ul style="list-style-type: none"> <li>• The resource recipient has the ability to demonstrate to the resource provider the performance obligation has been satisfied; and</li> <li>• The resource recipient has the ability to demonstrate to the resource provider the intended beneficiaries of the performance obligations have the ability to benefits from the delivered performance obligations.</li> </ul>

### **Matters for IPSASB Consideration 5**

At previous IPSASB Meetings, members expressed mixed views on re-expressing the concept of recognising revenue when control of goods and services have been transferred. This is of particular importance when a third party in an arrangement receives the benefits of the satisfied performance obligations.

The CP has taken the view that the key underlying principle for revenue recognition under a public sector performance based approach, is revenue should be recognised when (or as) performance obligations are satisfied.

We have considered that the resource provider receives the benefits of the goods or services delivered to resource beneficiaries when the resource provider has stipulated who the resource beneficiaries should be when entering into the funding arrangement. This thought process requires some mental gymnastics so we have not included this in the CP discussion.

1. Does the IPSASB agree with replacing the trigger for revenue recognition from when (or as) the entity “transfers control of a good or service” to when (or as) the entity “satisfies the promised performance obligations”?

If not, how would you suggest the IFRS 15 principle be re-expressed for the public sector?

2. In the summary table the public sector performance obligation approach requires two criteria to be met before revenue can be recognised. We are of mixed views if the second criterion is required:

The resource recipient has the ability to demonstrate to the resource provider the intended beneficiaries of the performance obligations have the ability to benefit from the delivered performance obligations.

Does the IPSAB consider the two criteria should be retained?

### **Specific Matters for Comment 2**

In your view:

- (a) Do you agree with the concept of re-expressing the performance obligation approach in IFRS 15, to capture broader range of revenue transaction in the public sector that contain performance obligations?
- (b) Do you agree the IFRS 15 revenue recognition model is an appropriate reference point to explore the extent to which a performance obligation could be developed for public sector revenue transactions involving the satisfaction of performance obligations.
- (c) Do you consider the re-expressed characteristics provided under paragraph 2.58 provide an appropriate and feasible basis for developing a public sector performance obligation approach.
- (d) Based on descriptions and discussion on a public sector performance obligation approach within with CP Chapter, would you encourage the IPSASB to continue exploring the use of a performance obligation approach to develop improved standard-level guidance for revenue recognition?
- (e) Are there any further modifications or guidance you would suggest be considered to allow the performance obligation approach to be extended to a broader range of public sector transactions?

Please explain the reasons for your views and comments.

#### **Matters for IPSASB Consideration 6**

1. Do you consider the re-expressed characteristics provided under paragraph 2.58 (and subsequent discussion) provide an appropriate and feasible basis for developing a public sector performance obligation approach?
2. Are there any further modifications or guidance you would suggest be considered to allow the performance obligation approach to be extended to a broader range of public sector transactions?

#### **Revenue transactions with no performance obligations (Category C transactions)**

- 2.134 The IPSASB acknowledges that the performance obligation approach will not be appropriate for public sector revenue transactions which do not involve the satisfaction of performance obligations, classified as Category C transactions for discussion purposes.
- 2.135 Category C transactions are those transactions not within the scope of Category A or Category B, and is therefore viewed as a residual category. It is anticipated that a residual standard will be required for these transactions, most of which are currently dealt with in IPSAS 23.
- 2.136 Category C includes revenue transactions with no performance obligations, including accounting for compulsory transfers (such as taxes, rebates and fines) and voluntary transfers (such as donations, grants and appropriations).
- 2.137 Under the performance obligation approach it is proposed that IPSAS 23 would be a useful starting point for revenue transactions, with no performance obligations as defined under the modified performance obligation approach. An objective of the CP is to explore modifications to IPSAS 23 to resolve current application issues, and to ensure IPSAS 23 provides adequate guidance for Category C transactions.
- 2.138 Under the performance obligation approach the requirement to distinguish revenue transactions as either exchange and non-exchange transactions will be removed and replaced by a requirement to distinguish revenue transactions as either those with performance obligations characteristics (which will apply a public sector performance obligation approach) and those transactions which do not satisfy the criteria to apply a public sector performance obligation approach (which will apply an IPSAS 23 based approach). Amendments to IPSAS 23 will be required to operationalize the boundary for recognition of revenue transactions under a performance obligation approach.

Discussion on the proposed amendments to IPSAS 23 to be developed and included in either Chapter 2, or 3, or both.

#### **Matters for IPSASB Consideration 7**

Potential modifications to IPSAS 23 are currently being considered by staff and will be presented at the September 2016 Meeting.

The current CP outline provides for IPSAS 23 modifications to be discussed in both Chapter 2 (Performance Obligation Approach) and Chapter 3 (Exchange/Non-Exchange Classification Approach).

Given the current number elements and principles discussed within Chapter 2, Staff feel it appropriate to revisit the best section to discuss potential IPSAS 23 modifications.

An alternative approach to discussing IPSAS 23 modifications in both Chapter 2 and Chapter 3, is to include the detailed discussion of IPSAS 23 modifications in either:

- A separate CP Chapter on IPSAS 23 Modifications; or

- Chapter 3, Exchange/Non-Exchange Approach, only

Both these approaches allow for Chapter 2 to focus primarily on performance obligation approach, addressing the key question: Can the performance obligation approach be expressed to enable the approach to be applied to a broader range of public sector transactions with performance obligation characteristics?

1. Does the IPSASB consider Chapter 2 - Performance Obligation Approach, should include the detailed discussion on potential modifications to IPSAS 23, or should these be addressed in another section of the CP?

## Application of a performance obligation approach to public sector expense transactions

### Introduction

- 2.139 This section of the CP Chapter explores the application of a performance obligation approach to certain expense transactions. The objective of this section is to seek feedback on application of the performance obligation approach to expense transactions.
- 2.140 The expansion of the performance obligation approach to expense transactions is not intended to revise existing requirements for exchange expenses. As described in Chapter 1 of this CP, specific transactions addressed in existing standards, such as IPSAS 25, *Employee Benefits*, are not within the scope of this approach. A list of existing requirements for specific expense transactions is included in Appendix A of this CP, including expenses associated with borrowing costs, leases, interest, employee benefits, and intangible assets.
- 2.141 As the IPSASB considered the application of a performance obligation approach for revenue transactions, the notion of applying the approach to expense transactions also was explored. After an initial assessment of the appropriateness of a performance obligation approach for the recognition of expenses, the IPSASB determined the approach is a viable alternative for the recognition of many expense transactions. For example, transactions often occur between public sector entities; therefore, the same transaction that generates revenue for one public sector entity may generate expense for another public sector entity. The same contract or arrangement could be evaluated for potential application of the performance obligation approach by both public sector entities.
- 2.142 Many of the principles within the performance obligation approach, developed as a revenue recognition model, could be applied to expense recognition. The five-step recognition model outlined in paragraphs 2.36-2.37 also can be considered for expense recognition. Paragraph 2.58 of this CP Chapter outlines the characteristics of a transaction this CP considers are required for a public sector performance obligation approach to be an appropriate model for the recognition of revenue arising from the satisfaction of performance obligations. Those same considerations are considered in this section to further apply the public sector performance obligation approach to expense transactions. Paragraphs 2.68-2.73 consider re-expressing the scope of the performance obligation model to include a broader range of revenue transactions in the public sector. The scope of IFRS 15 does not include any reference to expense transactions; therefore, the scope only requires modification to include expense transactions, not a change to the definition of an expense transaction.
- 2.143 Similar to the discussion in in paragraph 2.40 for revenue transactions, expense transactions can be classified in Category B (transactions with performance obligations) and Category C (transactions with no performance obligations). Because Category A is limited to transactions that are with the scope of IFRS 15, it would not be applied to expense transactions.

- 2.144 Application of the performance obligation approach to expense transactions requires a change in perspective. In the IFRS 15 approach, the parties to a contract are identified as the *entity* and the *customer*. Guidance is provided for the entity to evaluate the contract. The following terms are used in this section to identify the parties to the arrangements:
- **Customer:** A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.
  - **Entity:** A party that has contracted with a customer to provide goods or services in exchange for consideration.
  - **Resource Provider:** A party that has entered into an arrangement or agreement with a resource recipient to provide goods or services to a party other than the resource provider.
  - **Resource Recipient:** A party that has entered into an arrangement or agreement with a resource provider to provide goods or services to a party other than the resource provider.

*The public sector performance obligation approach (Category B transactions)*

- 2.145 The key characteristics of the public sector performance obligation approach have been considered below and re-expressed to consider the accounting for expenditure from the resource provider perspective. When considering whether a public sector expense transaction will be within the scope of a public sector performance obligation approach, the characteristics discussed below should not be considered independently, instead all characteristics are required to be considered together.
- (a) The funding arrangements are established through legal and non-legally binding arrangements
- 2.146 The CP proposes a performance obligation approach that would capture outflows that arise from arrangements other than contracts, such as enforceable legislation, regulation, and other binding arrangements that give rise to expense and related liabilities of public sector entities. The IPSASB's Conceptual Framework refers to both legally binding and non-legally binding obligations when discussing the concept of a present obligation for the purpose of defining a liability. The CP therefore proposes to include expenses that arise from both legally binding and non-legally binding obligations.
- 2.147 From an expense recognition view, the resource provider would consider whether it has the ability and intent to pay the consideration specified in the agreement. Many resource providers are required to have authorization or appropriation from a governing body to provide funding to other entities or enter into binding contracts. Therefore, the performance obligation model also could include consideration of jurisdictional appropriation or authorization policies.
- 2.148 The following Table 9 provides a summary of the public sector performance obligation approach characteristic expanded for expense recognition. The approach from the revenue perspective has been provided for comparison purposes.

<b>Performance obligation approach characteristic:</b>	
The rights and obligations in the agreement are established through legal and non-legally binding arrangements	
<b>Public Sector Performance Obligation Approach</b>	
<b>Revenue (Resource Recipient Perspective)</b>	<b>Expenditure (Resource Provider Perspective)</b>
<p>The rights and obligations in a transaction involving the satisfaction of performance obligations are established by an agreement between two or more parties.</p> <p>The agreement could take the form of a:</p> <ul style="list-style-type: none"> <li>• Legal and non-legally binding arrangements (as defined by the IPSASB Conceptual Framework 5.15); or</li> <li>• Performance obligations established by legislation or regulation, which are identifiable and enforceable.</li> </ul> <p>The intention is to include within the scope a broader range of arrangements that establish rights and obligations that meet the IPSASB Conceptual Framework definition of a liability.</p> <p>A key criterion of an agreement within scope is whether the agreement is enforceable by another party and performance obligations are identifiable and specific. Both the concepts of enforceability and identifiability, are discussed further below.</p> <p>Additional guidance will be provided for arrangements where the activities associated with the delivery of performance obligations commences before funding amounts have been confirmed or where it is not probable that funding will be received.</p>	<p>The rights and obligations in a transaction involving the satisfaction of performance obligations are established by an agreement between two or more parties.</p> <p>The agreement could take the form of a:</p> <ul style="list-style-type: none"> <li>• Legally and non-legally binding arrangement (as defined by the IPSASB's Conceptual Framework 5.15); or</li> <li>• Performance obligations established by legislation or regulations, which are identifiable and enforceable.</li> </ul> <p>If an agreement requires a resource provider to obtain authorization or appropriation from a governing body, based on the jurisdiction in which the resource provider operates, those authorizations or appropriations must be in effect and the probability that such authorization or appropriation could be revoked or revised should be remote for the agreement to be considered binding.</p>

(b) The arrangement requires the satisfaction of performance obligations, which benefits either the resource provider or resource beneficiary

2.149 Although public sector entities often enter into transactions to purchase goods or services, a significant number of expense transactions of many public sector entities do not involve the public sector entity directly receiving the benefit of performance obligations satisfied in exchange for the expenditure incurred. These expense transactions include the three party transactions in which a public sector entity (resource provider) provides resources to another entity (resource recipient) that benefits other parties (resource beneficiaries). Public sector

entities may serve as resource providers that must evaluate arrangements with resource recipients to determine expense recognition. The performance obligation approach would need to describe both types of relationships.

2.150 The IPSASB consider the description of resource provider and resource beneficiary under the performance obligation approach developed for revenue transactions in Table 3, could also be applied to expense transactions from the resource provider perspective. A minimum level of expansion or additional guidance will be required to enable the principle to be applied to expense transactions incurred by the resource provider.

(c) The agreed performance obligation in the arrangement are enforceable

2.151 To apply the performance obligation approach to expense transactions of public sector entities, the CP proposes the definition of enforceability be extended to include rights and obligations established through “legal or equivalent means”. The IPSASB’s Conceptual Framework uses the term “legal or equivalent means” within the Basis for Conclusions, paragraph BC5.31:

*Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means.*

2.152 The extended definition of enforceability under the performance obligation approach will also include non-legally binding arrangements, as this approach is consistent with IPSASB’s Conceptual Framework, Basis for Conclusions, paragraph BC5.33:

*On balance, the IPSASB agrees with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law.*

2.153 The IPSASB’s Conceptual Framework, paragraph 5.23, provides that non-legally binding obligations that give rise to liabilities (and therefore considered enforceable) have the following attributes

- (a) The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- (b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- (c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

2.154 In summary, the CP considers the concept of enforceability under a performance obligation approach will be established through legal or non-legally binding means. The extension of the definition of enforceability to expenses will be in accordance with the IPSASB’s Conceptual Framework. The proposed description of enforceability under the public sector performance obligation approach developed for revenue transactions in Table 4 also could be applied to expense transactions from the resource provider perspective. No expansion or additional guidance will be required to enable the principle to be applied to expense transactions incurred by the resource provider.

- (d) The agreed performance obligations within an arrangement are identifiable and specific
- 2.155 To apply the performance obligation approach to expense transactions, performance obligations imposed upon a resource recipient should be separately identifiable by the resource provider. The resource provider must be able to determine if the performance obligations have been satisfied by the resource recipient to determine if a present obligation of the resource provider exists. The description to define a performance obligation as identifiable and specific could be used from a resource provider perspective to encompass the types of arrangements common in the public sector.
- 2.156 The proposed description of identifiable and specific under a public sector performance obligation approach developed for revenue transactions in Table 5 could also be applied to expense transactions. No expansion or additional guidance will be required to enable the principle to be applied to expense transactions incurred by the resource provider.
- (e) The funding provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation
- 2.157 The total amount of funding agreed to by a resource provider could be defined as the amount of consideration the resource provider expects to pay in a binding arrangement. The nature of many transactions in the public sector is such that stand-alone prices may not exist for the promised goods and services or other performance obligations described in the binding arrangement. Additional guidance regarding allocation of the total amount of agreed funding by the resource provider will need to be developed.
- 2.158 The proposed description of the cost of delivery under a public sector performance obligation approach developed for revenue transactions in Table 7 could also be applied to expense transactions. The following Table 10 provides a summary of the public sector performance obligation approach characteristic expanded for expense recognition with the approach from the revenue perspective for comparison purposes.

<b>Performance obligation approach characteristic:</b>	
<b>The funding (or consideration) provided in exchange for the satisfaction of agreed performance obligations can be allocated to each identifiable and specific performance obligation</b>	
<b>Public Sector Performance Obligation Approach</b>	
<b>Revenue (Resource Recipient Perspective)</b>	<b>Expenditure (Resource Provider Perspective)</b>
<p>The entity shall allocate the total amount of funding to each identifiable and specific performance obligation in an amount that depicts the amount of funding (consideration) to which the entity expects to be entitled in exchange for satisfaction of the performance obligation.</p> <p>To meet the allocation objective, an entity shall allocate the total amount of agreed funding to each identifiable and specific performance obligation identified in the arrangement on an estimated cost of delivery basis.</p> <p>The resource recipient will need to demonstrate it can estimate the cost of delivering each identifiable and specific performance reliably.</p> <p>If a revenue transaction includes an identifiable donation component this should be excluded from the total amount of funding allocated across performance obligations, and recognized as revenue in accordance with the residual revenue standard for Category C transactions.</p>	<p>The resource provider shall allocate the total amount of funding to each identifiable and specific performance obligation in an amount that depicts the amount of funding (consideration) the resource provider expects to pay in exchange for satisfaction of the performance obligation.</p> <p>To meet the allocation objective, a resource provider shall allocate the total amount of agreed funding to each identifiable and specific performance obligation identified in the arrangement on a reasonable basis.</p> <p>If an expense transaction includes an identifiable donation component this should be excluded from the total amount of funding allocated across performance obligations, and recognized as expense in accordance with the guidance for Category C transactions.</p>

(f) Expense is recognized by reference to when (or as) the resource recipient satisfies the performance obligation

2.159 Under a public sector performance obligation approach, the CP proposes to express the trigger for expense recognition be when (or as) the entity “satisfies the promised performance obligation”. In a transaction involving three parties (resource provider, resource recipient and resource beneficiary), the resource provider recognizes expense when (or as) the intended beneficiary has the ability to benefit from the promised good or service delivered by the resource recipient. This approach relies on the resource provider being able to determine that the resource recipient has satisfied the performance obligation. This is particularly important in arrangements where promised goods or services are provided to resource beneficiaries.

- 2.160 Determining the satisfaction of performance obligations could be evidenced by reporting on progress to the resource provider. This might be a single progress report (for a performance obligation satisfied at a point in time) or a series of progress reports (for a performance obligation satisfied over time).
- 2.161 The following Table 11 provides a summary of the public sector performance obligation approach characteristic expanded for expense recognition, with the approach from the revenue perspective provided for comparison purposes.

<b>Performance obligation approach characteristic:</b>	
Revenue and expense are recognized by reference to when (or as) the resource recipient satisfies the performance obligation	
<b>Public Sector Performance Obligation Approach</b>	
<b>Revenue (Resource Recipient Perspective)</b>	<b>Expenditure (Resource Provider Perspective)</b>
<p>A resource recipient recognizes revenue when (or as) it satisfies each identifiable and specific performance obligations; this will occur when:</p> <ul style="list-style-type: none"> <li>The resource recipient has the ability to demonstrate to the resource provider the performance obligation has been satisfied; and</li> <li>The resource recipient has the ability to demonstrate to the resource provider the intended beneficiaries of the performance obligations have the ability to benefit from the delivered performance obligations.</li> </ul>	<p>A resource provider recognizes expense when (or as) the resource recipient satisfies each identifiable and specific performance obligation; this will occur when:</p> <ul style="list-style-type: none"> <li>The intended beneficiary has the ability to benefit from the delivered performance obligations; and the resource provider can determine that the resource recipient has satisfied the performance obligation.</li> </ul>

**Specific Matters for Comment 3**

In your view:

- (a) Do you agree with the proposal to apply the performance obligation approach to expense transactions in the public sector that require the satisfaction of performance obligations?
- (b) Do you agree with the proposed modifications to the performance obligation approach to allow the application of the approach to expense transactions?
- (c) Are there any further modifications or guidance you would suggest be considered to allow the performance obligation approach to be extended to expense transactions?

Please explain the reasons for your views.

*Expense transactions with no performance obligations (Category C transactions)*

- 2.162 Expense transactions without performance obligations will need separate guidance, whether that guidance is included in the same standard or a separate standard. Chapter 3 of this CP explores two potential approaches to providing guidance for non-exchange expense transactions of resource providers, which also could be used for expense transactions without performance obligations.

**Advantages of the performance obligation approach**

- 2.163 The performance obligation approach removes the need to make judgements about whether revenue and expense transactions are either exchange or non-exchange transactions. Instead transactions meeting a set of specific criteria will be accounted for under the performance obligation approach (Category A and Category B transactions) and other transactions will be accounted for under a residual approach (which could take the form of a modified IPSAS 23). We expect this approach will result in less revenue transactions being accounted for under a residual IPSAS 23 based approach.
- 2.164 The performance obligation approach provides an appropriate basis for accounting for public sector arrangements which are enforceable and require the satisfaction of performance obligations. Revenue and expense transactions under this approach, will be recognized in the accounting period in which the performance obligations are satisfied. The performance obligation approach supports the objective of faithful presentation of an entity's financial performance by recognizing revenue when earned and expenses when incurred. The performance obligation approach supports the presentation of information that allow users to assess the financial effectiveness and efficiency in which a public sector entity satisfies its performance obligations for the benefit of the public.
- 2.165 The IFRS 15 performance obligation approach represents an opportunity to improve current guidance because it replaces the previous limited revenue recognition requirements in IAS 18 and IAS 11 with a robust and comprehensive revenue recognition framework. This framework provides a basis that should be more easily applied to complex transactions and which can cope with multiple element arrangements and evolving nature of revenue and expense transactions.
- 2.166 The performance obligation approach achieves the objective of convergence with IFRS, where appropriate. Category A transactions which have similar characteristics to for-profit transaction will be accounted for in a consistent manner. The public sector performance obligation approach, proposed for Category B transactions, will allow a broader range of public sector transactions with performance obligations to be accounted for in accordance with performance obligation approach principles.
- 2.167 The performance obligation approach provides an opportunity to align revenue and expense standard-level requirements and guidance with the principles in the IPSASB's Conceptual Framework.

**Disadvantages of the performance obligation approach**

- 2.168 Extending IFRS 15 performance obligation approach to a broader range of transactions could result in boundary issues when distinguishing between transactions that should be accounted for in accordance with a performance obligation approach and general funding type transactions with no performance obligations. Current difficulties determining the exchange/non-exchange classification of each transaction, will be replaced with the need to

determine the performance obligation/non-performance obligation classification of each transaction.

- 2.169 The exchange/non exchange classification of revenue and expense transactions is a foundational concept within current IPSASs and is fairly familiar with preparers and users of public sector financial statements. The move to a performance obligation approach introduces new thinking and will introduce potentially a new set of interpretation challenges
- 2.170 IFRS 15 is not effective until accounting periods commencing on or after 1 January 2018 and therefore has not been widely adopted to date and has not been well-tested in practice. It will take some time for the application of IFRS 15 to be fully applied to different revenue transactions and consistent interpretation to be established in practice. It may take some time for any unforeseen outcomes from the application of IFRS 15 to become apparent.
- 2.171 The IFRS 15 performance obligation approach, introduces a new 5 step revenue recognition model. The revenue recognition model will introduce an increased level of complexity, and use of estimates and assumptions for certain public sector transactions with performance obligations. The determination when a performance obligation within an arrangement is identifiable, specific and enforceability could prove challenging when applied to certain public sector revenue and expense transactions.
- 2.172 The performance obligation approach requires the identification of each identifiable and specific performance obligation within an arrangement. The identification and accounting for each identifiable and specific performance obligation within an agreement separately could be difficult for large public sector agreements.
- 2.173 The application of the performance obligation approach to expenses transactions represents new ground, as the model used in IFRS 15 solely addresses revenue from contracts with customers. Guidance for expenses is not included in that model. To apply the performance obligation approach as a model for the recognition of expense may not be feasible or appropriate.

***PERFORMANCE OBLIGATION APPROACH******DISCUSSION OF REVENUE EXAMPLES*****Introduction**

1. This purpose of this paper to present some examples of Category A and B transactions to assist the IPSASB in considering the public sector performance obligation approach for recognizing revenue outlined in Chapter 2.
2. The examples discussed here are designed to explore how far the IPSASB thinks the public sector performance obligation approach should be extended and how flexible the key characteristics of public sector performance obligations could be in the Consultation Paper (CP). It's also an opportunity for the IPSASB to focus on what are the critical characteristics of public sector revenue transactions that mean the application of a public sector performance obligation approach may be appropriate.
3. Under the latest project plan the appendix to the CP containing illustrative examples to support any views expressed in Chapter 2 & 3 is due to be reviewed by the IPSASB at the September and December meetings. This paper also provides an opportunity for the IPSASB to provide feedback to staff in the development of examples prior to next IPSASB meetings.
4. The following category descriptions are described in Chapter 2:
  - **Category A:** Revenue transactions that are within the scope of IFRS 15. This category includes exchange transactions involving the transfer of promised goods or services to customers as defined in IFRS 15. They include transactions in which there is a contract with a customer and the performance obligations are clearly identifiable and enforceable.
  - **Category B:** Revenue transactions with performance obligations, but which do not necessarily contain all the characteristics of a transaction within the scope of IFRS 15. This category may include a range of exchange and non-exchange transactions with performance obligations. The approach for these transactions will be based on an IFRS 15 performance obligation approach, but re-expressed and expanded for the public sector. The performance obligations in category B may not be distinct, as the benefits may not be provided directly to the resource provider. The obligations may not be enforceable through a contract, but may be enforceable through other means. This category also includes public sector arrangements with performance obligations involving three parties – an entity that enters into an arrangement to provide a grant (resource provider), to another entity in return for delivering good and services (resource recipient) to a third party recipient (resource beneficiary). These transactions generally are classified as non-exchange transactions in current terminology, and may have either condition or restrictions.

This approach is referred to as the public sector performance obligation approach.
  - **Category C:** Revenue and expense transactions with no performance obligations. This category includes non-exchange transactions not within the scope of Category B. It is anticipated that a residual standard will be required for these transactions.

## Category A Revenue

### Back office Services

5. A Category A transaction is one in which there are clearly identifiable, enforceable performance obligations in a contract with a customer. A simple example to consider is a transaction in which public sector Entity X enters into a three year contract to provide back office services to public sector entity Y. Entity Y will pay Entity X a fee of CU120,000 per annum, payable quarterly in advance. The fee is based on a market rate for back office services. The following table describes how Entity X could evaluate the contract for back office services using the steps in IFRS 15.

<b>Steps to apply a performance obligation approach</b>	
Step 1 – Identify the contract with Customer	<ul style="list-style-type: none"> <li>• The parties to the contract, Entity X (vendor) and Entity Y (customer) can be identified and have approved the contract.</li> <li>• Each party's rights to services to be transferred can be identified.</li> <li>• The payment terms are identified.</li> <li>• The contract has commercial substance as there is a substantive business purpose for the nature and structure of the transaction</li> <li>• Entity Y intends to pay for the services in the contract and payment is considered probable.</li> <li>• The agreement between Entity X and Y satisfies the criteria for a contract.</li> </ul>
Step 2 – Identify the performance obligations in the contract.	The performance obligation is a recurring service contract where Entity X promises to provide continuous back office services to Entity Y for three years.
Step 3 – Determine the transaction price.	The transaction price of CU120,000 per annum is specified in the contract.
Step 4 – Allocate the transaction price.	This contract includes one performance obligation. The entire transaction price is allocated to continuous back office services.
Step 5 – Recognize revenue when (or as) a performance obligation is satisfied.	Entity X provides back office services monthly to satisfy the performance obligation and will recognize revenue every month. Under IFRS 15, Entity X recognizes revenue over time because Entity Y simultaneously receives and consumes all of the benefits. When quarterly payments are made in advance of the services being delivered, Entity X recognizes an increase in cash and a contract liability. The liability is settled once Entity X satisfies its performance obligation. The quarterly payment in advance does not represent a significant financing component of the contract.

**Matters for Consideration**

1. Does the IPSASB agree this shared services example is a category A transaction and it would be a useful example in the appendix of examples in the CP?

*Passport issuance*

6. In this example a citizen pays a one-off fee of CU200 to a public sector entity to have their passport renewed. The fee is paid in advance when the citizen applies for a new passport. The fee of CU200 is based on the public sector recovering its cost for producing and approving passports. A new passport is shipped to the citizen generally within 60 days from the date of receipt of the application. If the application is declined the fee of CU200 is not refunded.

<b>Steps to apply a performance obligation approach</b>	
Step 1 – Identify the contract with Customer	<p>The parties to the contract, public sector entity (vendor) and the citizen (customer) can be identified.</p> <p>Each party's rights and obligations are outlined in the passport application and can be identified. The public sector entity has the right not to renew the passport in the event the application does not meet the specified criteria and the application fee is not refunded.</p> <p>The payment terms are identified and the citizen pays the scheduled fee in advance.</p> <p>The contract has commercial substance as there is a substantive business purpose for the nature and structure of the transaction</p> <p>The agreement between the public sector entity and the citizen satisfies the criteria for a contract.</p>
Step 2 – Identify the performance obligations in the contract.	<p>The performance obligation is the delivery of a renewed passport from the public sector entity to the citizen or communication that the application has been declined.</p>
Step 3 – Determine the transaction price.	<p>The transaction price of CU200 per annum is specified in the application (contract).</p>
Step 4 – Allocate the transaction price.	<p>This contract includes one performance obligation. The entire transaction price is allocated to the delivery of the passport or communication that the application is declined.</p>
Step 5 – Recognize revenue when (or as) a performance obligation is satisfied.	<p>The public sector entity recognizes revenue when either the passport is shipped to the citizen or when the citizen is notified that the application is declined.</p> <p>When the citizen pays the fee in advance the public sector entity recognizes an increase in cash and a contract liability. The liability is settled once the public sector entity either ships the passport (in approximately 60 days) or communicates that the application has been declined.</p>

7. There can be a wide variety of government fees (user fees) in jurisdictions and depending on their economic substance may be considered as either exchange or non-exchange transactions. We believe the passport fee transactions is category A and is a typical public sector transaction involving a contract with customers that would be within the scope of IFRS 15.

**Matters for Consideration**

2. Does the IPSASB agree this government fee example is a category A transaction and it would be a useful example in the appendix of examples in the CP?

**Category B Expenses**

8. Category B transactions are those in which there is some form of performance obligation, but some of the criteria for use of the model defined in IFRS 15 are not satisfied. Below are three examples of transactions that were introduced at prior meetings, but have been expanded for this discussion. They include a three-party transaction, a research grant, and a grant for a specific program with no specification of which goods or services should be purchased

*Three-Party Transaction*

9. In the December 2015 agenda papers, the revenue project evaluated the application of the performance obligation approach to a grant currently classified as a non-exchange transaction, but that has a performance obligation that is clearly defined. That example of a vaccination grant is described below to evaluate the application of a performance obligation approach from a resource recipient's view.

Summary of agreement	Grant from a central government (resource provider) to a local government health entity (resource recipient) to subsidize a portion of a vaccination program for residents of the community (resource beneficiary)
Specifications	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. The vaccinations must be administered to the community in the next year's program.
Cost	The central government 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.  Assuming the cost of each vaccination is CU10, and that the central government expects the local government to perform the maximum number of vaccinations allowed in the contract, or 500 vaccinations, the central government would expect to pay:

	CU10 x 500 x 50% = CU2,500
Payment terms	The grant resource provider will pay 100% of the grant in advance with the expectation that all 500 vaccinations will be administered in the next financial year. The agreement states that if the vaccinations are not all delivered in the next year the local government health provider is required to return the funds based on the value of undelivered vaccinations.
Availability of funds	The central government has authority to spend the funds.
Eligibility criteria	No specific criteria over and above the specifications set out above.

10. In the table below we have discussed each characteristic outline in Chapter 2 using the vaccination example.

Scope is limited to revenue (excluding "gains")	<p>The grant from the central government to the local government health entity is not an ownership contribution, and the receipt of funds meets the definition of an increase in the net financial position of the local government health entity.</p> <p>We note that the public sector performance obligation approach will need to scope out "gains" such as those arising on the sale of PPE. IFRS 15 effectively does this through the reference to income arising in the course of ordinary activities.</p>
The rights and obligations in a transaction are established by an agreement between two or more parties (and the parties are committed to perform their respective obligations)	<p>IFRS 15 requires performance obligations are established through a contractual agreement. However under the public sector performance obligation approach this has been broadened to include other forms of agreement.</p> <p>We have assumed for this example there is a written agreement between the central government and the local government health provider identifying the rights and obligations of the parties which is a contract.</p>
The agreement requires the delivery of goods or services to a customer	<p>In this example, it's not clear who the customer is because the vaccinations are being delivered to the community but the consideration is paid by the central government. There are two broad choices: By analogy, label one of the parties as the "customer" or explain that in a three party transaction there isn't a customer but still accept it is in the scope of the public sector performance obligation.</p> <p>Under the first option, Chapter 2 suggests that the central government would be the customer as they can be viewed as receiving substantially all the benefits when they have the ability to direct who receives the benefits of the goods and benefits and this</p>

	<p>supports the central government's achieving its objectives with the funds.</p> <p>In the second option, the specification of goods or services to be delivered by the local government health provider in exchange for the central government grant is enough to be in the scope of the public sector performance obligation approach and no one is labelled as the customer.</p>
<p>The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined</p>	<p>The agreement is very specific in terms of timeframe, quantity and quality of vaccinations to be delivered.</p> <p>The local government health provider would need to demonstrate that the performance obligation has been satisfied. In this example it's likely to be achieved because individual patient records are kept and the health provider can trace batches of vaccinations administered because of the nature of the medical goods and services being delivered.</p>
<p>The rights and obligations in the agreement are enforceable.</p>	<p>While the local government is able to report the number of vaccinations administered, in our view, enforceability is a more substantive characteristic than the action of reporting back on delivery of services. Communication between the central government and the local government provider on the vaccination program is vital, but both parties need to be satisfied that all the rights and obligations are enforceable in the agreement.</p> <p>There are a number of factors in this example that suggests it's enforceable. The obligations on the local government health provider are clear and the amount of funding is specific. There is a clause in the agreement that requires the funds to be returned to the central government if not used for the intended purpose. The intent is that the funds have been provided conditional on the vaccinations being delivered, even though the full grant has been paid in advance.</p> <p>The local government health provider is paid in advance, so on rolling out the vaccinations, their right to receive funding is immediately received on delivery.</p> <p>With the central government having made an advance payment, their power to enforce may be partially diminished because they now must rely on the health provider to either deliver or return the funds.</p> <p>If the local government health provider does not deliver the vaccinations and does not return the central government's value of the vaccinations, the central government could take legal action against the health provider. In practice because of the legal costs</p>

	<p>involved this action is not often taken. Enforcement of the contract may be through some governmental administrative process or some veto power of the central government over the local government health provider. The consequences may take other forms like withholding the following year's funding, or pressure through another means on the health provider to act.</p> <p>We note that where a central government withholds funding and pays in installments after satisfaction of performance obligations, they may have more power to enforce the contract. The central government rights in the contract do not include the ability to enforce a vaccination program to be delivered, but protects the the government's funds in the event the program is not delivered.</p> <p>The control of cash by the resource provider prior to confirmation that services have been delivered may be an important factor in determining the ability to enforce an agreement. However, in our view it should not necessarily be assumed that when the central government pays in advance a contract is not enforceable, because there is no return condition.</p> <p>A variation on this example is where the agreement is the same, but the central government pays the funding in advance with no return obligation. Does this change the substance of the agreement because the central government may not be able to secure the return of the funding in the event the vaccinations are not delivered? Is the health provider's obligation to deliver all 500 now more akin to a moral one because they have already received 50% of the funding upfront, but have no return obligation in the event they don't deliver?</p>
<p>The transaction price can be allocated to the public sector performance obligation in the agreement</p>	<p>In this example we have assumed the funding is conditional on each vaccination being administered to the community and the funding per vaccination is identified in the agreement. In this fact pattern, we would argue the distinct good or service is the administering of each vaccination, based on the requirement that the portion of funding for the vaccinations not delivered is returned.</p> <p>In another example, it is possible the agreement may be written so the central government is not obligated for its 50% funding until all 500 vaccinations are administered. This may be based on a policy that the benefits of a vaccination program are effective only if a certain minimum number of the community are vaccinated.</p> <p>In this latter example the question is has the substance of the performance obligation changed? We believe the example is still a</p>

	<p>category B transactions, but the point at which revenue is recognized may have changed depending on the judgments applied. The question becomes - should the revenue be recognized (a) only on delivery of the 500<sup>th</sup> vaccination, (b) accrued over time based on the actual roll out of vaccinations over time or (c) at the beginning of the year based on the high probability that the 500 vaccinations will be achieved. IFRS15 contains guidance when revenue is recognized over time or at a point in time. We believe the public sector performance obligation approach is also likely to require similar guidance around this issue.</p>
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11. In our view the vaccination example would be a category B transaction, because there is some form of performance obligation, but some of the criteria for use of the model defined in IFRS 15 are not satisfied. In our view the characteristic of the vaccination agreement means the public sector performance obligation approach could be applied using the following 5 steps:

Step 1 – Identify the agreement and the parties to the agreement

Step 2 – Identify the performance obligations in the contract.

Step 3 – Determine the transaction price.

Step 4 – Allocate the transaction price.

Step 5 – Recognize revenue when (or as) a performance obligation is satisfied.

**Matters for Consideration**

3. Does the IPSASB agree this vaccination example is a category B transaction and it would be a useful example in the appendix of the CP?
4. Does the IPSASB have any views on which vaccination fact pattern discussed above (e.g. funds paid in advance or in arrears) would be more effective in demonstrating the public sector performance obligation approach described in Chapter 2?
5. Does the IPSASB think that agreements where performance obligations are clearly specified, but where there is no return condition specified (in the event a resource funder pays a resource recipient in advance of any performance obligations being satisfied) should be considered a category B transaction (to which the public sector performance obligation approach described in Chapter 2 should be applied)?

*Research Grant*

12. A research grant involves payment for the conduct of research. Although the terms and conditions of research grants may vary, the core principle is that an entity is providing funding for the research activities to occur. The rights and obligations of each party are typically described in a research agreement. Some research grants may be considered to be exchange transactions in current terminology, but many are classified as non-exchange as the entity providing funding often does not receive benefits equal to or nearly equal to the resources provided.

13. Research grants involve obligations to complete certain research activities, document findings, and communicate results. Some research grants involve the creation of intellectual property, which may or may not become the property of the entity funding the research. The requirements of a research grant may constitute performance obligations. Although there is no transfer of services directly to the resource provider, the grant agreements nevertheless may impose enforceable obligations on the recipients and create rights for the provider.
14. The following example of a research grant was initially discussed at the December 2015 meeting and is used to demonstrate how the expanded performance obligation approach could be applied to the resource recipient view:

Summary	A government agrees to fund a five year project to develop ground motion prediction models for global shallow crustal earthquakes.
Specifications	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 by a public sector University, using the University's facilities. The agreement commences on the effective date and terminates at the completion of the project.
Cost	CU500,000 CU100,000 to be provided at the beginning of each year. The public sector University does not have to refund any unspent money.
Availability of funds	The funds for the project have to be appropriated each year. Authority has only been given for the first year of research.
Other	The University has the right to publish the results of the research.

15. In the table below we have discussed each characteristic outline in Chapter 2 using the University research example.

Scope is limited to revenue (excluding "gains")	The research grant from the central government to a public sector University is not an ownership contribution, and the receipt of funds meets the definition of an increase in the net financial position of the University.
The rights and obligations in a transaction are established by an agreement between two or more parties (and the parties are committed to perform their respective obligations)	The contract has been approved by both parties and the payment terms can be identified by both the government and the University. The contract has commercial substance and it is probable that the government will pay the first year's annual grant to the University. The grant in subsequent years is subject to the central government approval annually.

<p>The agreement requires the delivery of goods or services to a customer</p>	<p>There is a performance obligation in that the University is required to perform the research according to the terms specified in the research agreement in order for the central government to be bound to payment.</p> <p>However, the rights to goods and services to be transferred to a customer is not easily applied in this example, as there is no transfer of research results to the government. This contract does not include a promise from the University to transfer control of the research or research results to the government.</p> <p>In that sense the government doesn't easily satisfy the definition of a customer because the main beneficiary as a result of the research appears to be the University itself. The University is not required to publish the research, but can do so if they wish. There also appears to be no restraint on the University selling the intellectual property or research itself. As a result the government does not appear to even have a right to direct the benefits of the research to the wider community.</p> <p>On the other hand it could be argued that improving the research in this subject at this chosen University meets the wider R&amp;D objectives of the government. The fact that the government has only specified one output as evidence of the research being conducted, shouldn't distract from the research being a substantive performance obligation under the agreement. Therefore a under a more flexible performance obligation approach the specification of research to be delivered by the University in exchange for the government grant could be enough to be a category B transaction.</p> <p>The significant question is whether the University's performance obligation is conducting the research over time (culminating in an annual progress report) or the performance obligation is the delivery of the annual report summarizing year's work. In our view it is the former because the substantive act under the contract is performing the research itself, which is subsequently evidenced by the annual progress report.</p>
<p>The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined</p>	<p>As noted above the specificity of the research agreement would need to be carefully evaluated to determine the performance obligations. Some research agreements may include milestone achievements that could be considered to be distinct performance obligations. The example here requires an annual progress report, but does not specify particular milestones to be achieved in a given year or specify any minimum quality standard in relation to the research.</p>

	<p>The University would need to determine whether performance of the research is over time (as the research is conducted) or at a point in time when the annual report is provided. As noted above there is a question around how substantive the act of writing an annual progress report is in comparison to the requirement to carry out the actual research over the year.</p> <p>Using an IFRS 15 requirement, the University may satisfy a performance obligation and recognizes revenue over time if the government (loosely considered as the customer) simultaneously receives and consumes the benefits provided by the university's performance as the entity performs.</p> <p>The answer to this question is dependent on whether you believe the University conducting this specific research means the government is simultaneously benefiting from the increased R&amp;D activity, or only benefiting when they receive an annual progress report. While this is a test in IFRS 15, it could also be argued that the government is not benefiting as a "customer" from either the research activity during the year or from receipt of the annual progress report. If this view is taken the agreement may be considered to have no substantive or distinct performance obligations and be a category C transaction.</p> <p>From the university's perspective, and ignoring the need to specify a customer in a pure IFRS 15 sense, it could be argued that the obligation of conducting research over the year is like building an incremental "research asset" over time (even if the cost of research is expensed, rather than capitalized). This would result in the University more likely to recognize revenue over time as the research is conducted and the university adds to its intellectual asset base.</p>
<p>The rights and obligations in the agreement are enforceable.</p>	<p>The grant agreement between the government and the University arguably creates enforceable rights and obligations, even though no transfer of research results is anticipated. However judgment needs to be applied.</p> <p>While the University is required to report an annual progress report, the only consequence of not doing so appears to be the potential loss of funding in the subsequent year. That is because the government is effectively only committed to funding subsequent year's research through the annual appropriation process. However, for the first year of research where the government had paid the annual funding in advance, the government's position may be weakened because the University</p>

	<p>has no obligation to return the funds in the event they failed to conduct the research or produce the progress report.</p> <p>While the annual funding agreement appears to be conditional on the research being conducted, the central government may have limited discretion to enforce this condition once the funding has been paid in advance.</p> <p>If the University does not conduct the research and delivery the progress report, it's possible the government will take legal action to enforce the obligations in the agreement. But because of the high legal costs and the University is a public sector entity, there may be little benefit to the community in suing the University. It's possible that enforcement of the contract may be through some governmental administrative process or some veto power of the central government over the University. As noted above, the consequences may take other forms like withholding the following year's funding, reducing other government funding streams or through political pressure on the University to act</p> <p>As noted above in the vaccination example, we observe that where the government withhold funding and pay installments or pay in arrears on satisfaction of performance obligations, the easier it is to provide evidence the government has the right to enforce the contract. It's should be noted that even with paying funds in arrears, the government rights do not include the ability to force the research to be done, but at least provide protection of the government's funds in the event the research is not done.</p> <p>The control of cash by the resource provider prior to confirmation that services have been delivered may be an important factor in determining the ability to enforce an agreement. However, it should not necessarily be assumed that when the central government pays in advance a contract is not enforceable, although it may be harder in practice when there is no return condition.</p> <p>Some may argue in this scenario that the University's obligation to conduct the research is in substance akin to a moral or political one because they have already received 100% of the funding upfront and no return obligation is specified in the event they don't.</p>
<p>The transaction price can be allocated to the public sector performance obligation in the agreement</p>	<p>The transaction price is specified in the contract.CU500,000 payable in equal amounts over 5 years. However, the government commitment to subsequent funding beyond the first year is subject to the future budget decisions (through the appropriation system)</p>

	Allocation of the transaction price will depend upon the assessment of the performance obligations identified in the agreement. On balance we would argue the CU100,000 annual revenue should be spread and recognized each month (either on an outputs method or an inputs method), as the substantive performance obligation is the actual research carried out each month. While the annual progress report is an important document under the agreement, its primary purpose is to provide evidence that the substantive act of research was conducted as agreed.
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16. In our view the University example on balance would be a category B transaction, because there is some form of performance obligation, but some of the criteria for use of the model defined in IFRS 15 are not satisfied. However, this conclusion can only be reached if the public sector performance obligation is relatively flexible around:
- interpretation of the “customer”;
  - the connection between the customer and benefits obtained by the customer; and
  - enforceability of the contract when the government’s ability to enforce the contract may be weakened when the annual funding is provided upfront with no return condition in the event the research is no conducted.
17. If this flexibility was reflected in the public sector performance obligation approach, the revenue from the University agreement could be applied using the following 5 steps:
- Step 1 – Identify the agreement and the parties to the agreement
- Step 2 – Identify the performance obligations in the contract.
- Step 3 – Determine the transaction price.
- Step 4 – Allocate the transaction price.
- Step 5 – Recognize revenue when (or as) a performance obligation is satisfied.

**Matters for Consideration**

6. Does the IPSASB agree this University research example is a category B transaction and it would be a useful example in the appendix of the CP?
7. Does the IPSASB have any views on which University research fact pattern discussed above (e.g. funds paid in advance or in arrears) would be more effective in demonstrating the public sector performance obligation approach described in Chapter 2?

*Grant for a specific program with no specification of which goods or services should be purchased*

18. Grants for a specific program classified as Category B may be one in which the grant specifies the program that should use the funds, but does not specify which goods or services should be purchased using the grant funds in order to carry out that program. There is an obligation to spend the funds to support a program, but the grant does not require use of the funds for a particular good or service. The obligation in this case is a stipulation as described in the current IPSASB literature - IPSAS 23.

If the stipulation includes a provision requiring funds to be returned if they are not used in the manner specified, the stipulation is a condition. If not, it is a restriction.

19. The interaction between performance obligations and stipulations is described in paragraph 15 of IPSAS 23 as follows:

Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached (return obligation).

20. Although a requirement to use grant funds to support a particular program imposes a restriction upon the recipient, the restriction is not sufficiently specific or enforceable to be considered a performance obligation. A condition that imposes a return obligation on a recipient if the funds are not used as specified may meet the definition of a performance obligation.
21. To illustrate the application of the public sector performance obligation approach to a grant with a condition, consider the following example adapted from the December 2015 papers for a grant to a local government health department to provide dental services. In the example, the grant is to support the dental services in general, but there is no specification of the exact services to be provided, or particular goods to be purchased to support the provision of dental services. If the funds are not spent to support the dental services, the funds must be returned to the central government.

Summary	A central government provides a grant to a local government health provider to support the provision of dental services.
Specifications	Specific goods or services are not specified. Funds are to be used to support dental services provided by the local government health department. Funds not used in this manner must be returned to the central government. The local government must provide periodic reporting to the central government regarding the dental services provided, including types of services, number of patients served, and total costs incurred by the dental services unit.
Cost	CU200,000 per annum. Payment of the grant is spread based on a schedule of payments spread evenly every month. This schedule is broadly in line with the costs of the local government health provider.
Availability of funds	The central government is authorized to provide the grant.

22. In the table below we have discussed each characteristic outlined in Chapter 2 using the grant for a specific program.

Scope is limited to revenue (excluding “gains”)	The grant from the central government to the local government health provider is not an ownership contribution, and the receipt of
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	<p>funds meets the definition of an increase in the net financial position of the local government health entity.</p>
<p>The rights and obligations in a transaction are established by an agreement between two or more parties (and the parties are committed to perform their respective obligations)</p>	<p>The agreement has been approved by both parties and the payment terms can be identified by both the central government and the local government.</p> <p>IFRS 15 requires performance obligations are established through a contractual agreement. However under the public sector performance obligation approach this has been broadened to include other forms of agreement.</p> <p>The contract has commercial substance and it is probable that the central government will pay the grant to the local government. This contract does not include a promise from the local government to transfer control of specific goods or services to the central government. However, there is a performance obligation in that the local government must use the funds to support the provision of dental services or return the funds to the central government.</p>
<p>The agreement requires the delivery of goods or services to a customer</p>	<p>In this example, it can be argued the stipulation to use funds to support provision of dental services is a single performance obligation.</p>
<p>The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined</p>	<p>The rights to goods and services to be transferred is not as easily applied in this example, as the grant agreement does not specify any specific goods or services to be provided, only the stipulation that the funds be used in support of the local government providing dental services in general.</p> <p>The public sector performance obligation approach could be expanded to include the stipulation (condition) on use of funds as the performance obligation of the local government. The question that arises is whether the stipulation is sufficiently specific to allow the local government health department to demonstrate satisfaction of the restriction as a performance obligation. If so, the public sector performance obligation model could be applied.</p> <p>To further support this, it could be argued that the local government health provider must incur the costs in relation to the provision of dental services, before the central government is obligated to reimburse the costs in the agreement.</p>
<p>The rights and obligations in the agreement are enforceable.</p>	<p>The grant agreement between the central government and the local government health provider creates enforceable rights and obligations.</p>

	<p>In practice the question of enforcing the contract is unlikely to surface because the local health provider has a lot of discretion to spend and deliver dental services within a broad objective. We imagine it would be difficult to breach the requirement because the program objective is so wide. The same funding arrangement and delivery of dental services may have been in place for many years and this may have created a valid expectation in the minds of the local government to ongoing funding, without thinking about the performance obligation underpinning the arrangement.</p> <p>Alternatively, the continuous funding practice for the program could be considered as an implicit reimbursement of the local government health provider's costs incurred in relation to the provision of dental services.</p>
<p>The transaction price can be allocated to the public sector performance obligation in the agreement</p>	<p>As dental services are provided, the local government health department satisfies the performance obligation.</p> <p>The central government requires the local government health department to demonstrate satisfaction of the performance obligation through periodic reporting even though control of the dental services is not transferred to the central government.</p> <p>The alternative view is that the local government health provider is entitled to recognize the funding at an earlier point, when the central government has the annual funding approved in the appropriation process, because the performance obligations within the arrangement are not specific and substantive.</p>

**Matters for Consideration**

8. Does the IPSASB think the grant for a specific program (for which there is no specification of goods and services to be delivered) is a category B transaction for the public sector performance obligation approach described in Chapter 2?

**ISSUES PAPER, NON-EXCHANGE TRANSACTIONS—OTHER  
RESOURCES AND OTHER OBLIGATIONS****Introduction and Background**

1. Feedback received from some preparers indicates implementation challenges associated with the treatment of resources received from non-exchange transactions that are intended for future periods, but are recognized in the current reporting period. This feedback has indicated that the resources received by the recipient do not give rise to a liability and the resources transferred by the transferor do not give rise to an asset; however, some believe those transactions also do not relate to the current period. There are several alternatives that will be considered at the next meeting, including the use of other resources and other obligations and a number of presentation alternatives.
2. Because a majority of the current Board members did not participate in the deliberations leading to the issuance of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Conceptual Framework), this paper provides a brief history of the development of the financial statement elements including references to other resources and other obligations in the basis for conclusions. To set the stage for the September deliberations, the paper then applies the definitions of financial statement elements in the Conceptual Framework to three example transactions.

**Brief History**

3. The IPSASB's approach to models of financial performance to be reported in the financial statements, including the treatment of other resources and other obligations is described in the Basis for Conclusions of the Conceptual Framework. The discussion in paragraphs BC5.37-BC5.58 is summarized in this section of the paper.
4. After considering stakeholder feedback to the Consultation Paper, *Elements and Recognition in Financial Statements*, and an Exposure Draft with the same title, the IPSASB determined that other resources and other obligations would not be specifically identified as separate elements in the Conceptual Framework; however, the IPSASB did conclude that "accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in the financial statements in order to meet the objectives of financial reporting." The Board believed that using this approach met the objectives of financial reporting because "the circumstances under which other obligations and other resources will be recognized will be determined at the standards level and explained in the Bases for Conclusions of specific standards."

**IPSASB Elements**

5. As the elements of financial statements were being developed, the IPSASB considered the potential use of other resources and other obligations if a transaction needed to be recognized, but did not give rise to any of the six elements described in the Conceptual Framework. Entities must determine if the transaction gives rise to an element that meets the following definitions of an asset or a liability:
  - Asset: a resource presently controlled by the entity as a result of a past event; or

- Liability: a present obligation of the entity for an outflow of resources that results from a past event.
6. An entity also determines if the transaction gives rise to an element that meets the following definitions of revenue, expense, ownership contributions, or ownership distributions:
- Revenue: increases in the net financial position of the entity, other than increases arising from ownership contributions;
  - Expense: decreases in the net financial position of the entity, other than decreases arising from ownership distributions;
  - Ownership contributions: inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity; or
  - Ownership distributions: outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.
7. If the transaction does not give rise to any of the six elements that are defined in the Conceptual Framework, the entity still may need to recognize the transaction in its financial statements only if specifically required or permitted by an IPSAS. Other obligations are used for obligations that do not meet the definition of a liability that the IPSASB considers should be recognized in order to meet the objectives of financial reporting. Other resources are used for resources that represent an outflow of service potential or economic benefits provided to another entity, but do not represent a decrease in the net financial position of the entity providing the resources in the current period.

## Examples

8. This section describes the application of the Conceptual Framework and related hierarchy to three example transactions: (1) transfers made prior the end of the period for use in the next period; (2) grants for multiple years; and (3) property taxes levied in one period for use in the next period. Again, the intent of this paper is not for the Board to draw any tentative conclusions regarding recognition or reporting alternatives, but only to introduce subject matter that will be further explored at the next meeting.

### *Transfer*

9. Transfers often occur between levels of government and may occur near the end of a reporting period for use in the next period. For example, a national government makes a transfer of CU10 million to a local government at the close of business on 30 June. The national government does not impose any conditions on the use of the funds. There is a restriction that the funds cannot be used by the local government until the beginning of the local government's fiscal year on 1 July; however, there is no return obligation or withholding mechanism. The national government's fiscal year also is from 1 July to 30 June.
10. This transaction can be evaluated from the view of both the provider and the recipient. From the provider's view, the national government must first determine whether or not the transfer of funds that decreases cash gives rise to an element that meets the definition of an asset or liability. For the national government to recognize the asset, the national government must control resources as a result of a past event. The national government does not have control of resources, either those

transferred or any other resources of the local government, as a result of the transfer. Therefore, one could conclude that the national government should not recognize an asset.

11. The outflow of resources is not a distribution to owners; therefore, if an asset is not recognized the national government now evaluates if the transaction gives rise to expense. The national government is worse off from a cash standpoint; however, IPSASB standards are accrual basis, not cash basis. The decrease in cash relates to a future time period. The funds are not permitted to be used by the local government until 1 July. Therefore, the issue is whether this transfer represents another economic phenomenon. While the passage of time is not controlled by the national government, it does establish when the resources can be used and may give rise to an economic phenomenon.
12. On the other side of the transaction, the local government now controls the access to the transferred funds. The transfer gives rise to an asset, cash, of the local government. The local government also must determine if the transferred asset gives rise to a liability.
13. The local government does not have to satisfy any performance obligation related to the use of the funds, nor is a condition or refund mechanism specified. As there is no present obligation for an outflow of resources from the local government; therefore, one could conclude that a liability should not be recognized.
14. The national government does not have and is not obtaining an ownership interest in the local government. If a liability is not recognized, the local government must now determine if the transfer gives rise to revenue. The local government is better off from a cash standpoint; however, the receipt of cash does not in all cases result in the recognition of revenue. The local government cannot use the funds until its fiscal period begins. Again, the issue is whether this transfer gives rise to another economic phenomena. While the passage of time is not controlled by the local government, the national government did establish when the resources can be used which some contend is an economic phenomena.

#### *Multi-year Grants*

15. Grants provided and received by governments may include various terms including the purpose and time restrictions. In addition to providing funds in advance, as in the transfer example described above, some grants provide funding for more than one year. The funding may be paid over the time period specified in the grant or may be paid in a single amount at the beginning of the grant.
16. To illustrate this type of transaction, a state government enters into a grant agreement to provide a local government social housing entity CU100,000 per year for the next 5 years. The social housing entity's objectives are to provide assistance to affordable housing resources. The grant requires the social housing division to use the funds in any manner to support the social housing entity's objectives, but does not impose any purpose restrictions. The grant does not specify a refund provision. The state government pays the entire amount of the grant (CU500,000) to the local government social housing entity at the beginning of the agreement.
17. The decision by the state government to pay the entire amount of the grant is a cash flow decision that should not dictate the accounting for this transaction on an accrual basis by either party. Public sector entities may have many reasons for making certain cash flow decisions, including, but not limited to, budget restrictions and pending expirations of appropriated funds. Those cash flow decisions may not faithfully represent the underlying economics of the transaction. Furthermore,

recording the entire transaction on day one of the arrangement for resources that are intended to finance activities for a multi-year period is arguably not providing relevant information.

18. The state government must evaluate whether the grant gives rise to an element that meets the definition of an asset or liability. The state government no longer controls the asset, as the transfer has been made. The state government considers whether the decrease in cash gives rise to an asset, a prepaid expense. A pre-funded grant agreement does not necessarily give the state government control of resources as a result of a past event. The state government does not have an enforceable claim to resources. Therefore, one could assert that the state government should not recognize an asset.
19. The outflow of resources is not made to an owner; therefore, if an asset is not recognized the state government would evaluate if the transaction gives rise to expense. The grant agreement is for multiple periods, only one of which is considered the current period. The transfer of funds therefore relates to both the current period and future time periods. The outflow of resources for the first year, or CU100,000, meets the definition of current period expense. Therefore, the issue is whether the resources for the remaining four years, or CU400,000, represents another economic phenomena. While the passage of time is not controlled by the state government, it did establish when the resources can be used which some contend is an economic phenomena.
20. In this example, the recipient is a public sector entity and considers the same elements defined in the Conceptual Framework. The local government social housing entity now has CU500,000 in cash. The local government social housing entity must evaluate whether the increase in an asset gives rise to a liability. Although the terms of the grant specify that the funds be used to support the local government social housing entity's objectives, that requirement may not be sufficient to impose a condition, which gives rise to a present obligation for an outflow of resources of the social housing entity. If that is the case, the social housing entity does not have a present obligation.
21. The state government does not have and is not obtaining an ownership interest in the social housing entity. If the social housing entity determines that it should not recognize a liability, it would consider whether the transaction gives rise to revenue. The agreement specifies a grant of CU100,000 per year for the next five years, for a total of CU500,000. The grant agreement includes a time restriction that the funds be used pro-rata over the next five years. Again the issue is whether the restriction to use the resources over the remaining four years, or CU400,000, gives rise to an economic phenomenon.

#### *Property Taxes*

22. Several types of taxes are levied in many jurisdictions, one of which is a property tax. The taxable event for property taxes is generally the passing of the date on which the tax is levied, or the period for which the tax is levied. Some jurisdictions levy taxes prior to the period for which those property tax resources are to be spent. For example, a local government levies property taxes on 30 November that are collected from taxpayers or become due on 31 December. Total property taxes levied of CU50 million are required by law to be used by the local government in the upcoming fiscal year beginning on 1 January. Of the CU50 million, CU10 million are collect by 31 December. The remaining balances are collected by 31 January.
23. In the situation described above, the local government must evaluate if and when the transaction gives rise to elements that meet the definition of an asset or a liability. On December 1, the local government controls resources from taxpayers for the amounts collected as the local government

has access to the resources. The Conceptual Framework provides indicators of control, which include “the existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.” The local government holds the cash for the receipts collected on or before 31 December and has an enforceable right to the uncollected property taxes because the tax has been levied. Therefore, the local government recognizes a receivable for the amounts due from taxpayers at 31 December (CU 40 million).

24. The local government must now consider the credit using the elements defined in the Conceptual Framework. The local government considers whether the property taxes levied, either collected or uncollected, give rise to an element that meets the definition of a liability. In this example, there is no present obligation of the local government for an outflow of resources. The local government has levied and collected the tax in accordance with its laws; therefore, no outflow of resources is expected. Also, the property taxpayers do not own the government and the inflow of resources is not a contribution from owners.
25. The entity now considers whether the property taxes levied meet the definition of revenue. As described above, revenue represents an increase in the net financial position of an entity, other than increases arising from ownership contributions. The property taxes have been levied for use in the fiscal year beginning on 1 January; therefore, the period in which the taxes can be used has not begun. In this type of transaction, the government controls every aspect—when the taxes are levied and when the taxes are due. The one point where there is less control is the period for which the taxes are levied. For example, it would be not likely that a government would levy the same tax twice for the same period. Therefore, the issue is whether the period for which the tax was levied give rise to other economic phenomena. While the passage of time is not controlled by the government, it did establish by law when the resources can be used, which some contend gives rise to an economic phenomena. Based on that viewpoint, the entire tax levy of CU50,000 could be recognized as an other resource.

## REVENUE AND EXPENSES

### IPSAS 23 Directions for September

#### Objectives

1. The objective of this paper is to facilitate the discussion of future work on issues associated with IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and seek direction from the IPSASB about the nature and extent of that work and the relative priority of various aspects. We are seeking feedback about which IPSAS 23 related issues need to be addressed in the Consultation Paper, how much work the IPSASB wants done on these issues and the timing of this work.
2. These issues obviously need to be considered in conjunction with the broader project plan.

#### Background

3. In September 2015 the IPSASB's agenda included an issues paper on IPSAS 23 (refer agenda item 8.1, September 2015). The purpose of that paper was to seek feedback from the IPSASB on the key issues that should be considered when reviewing the requirements for revenue from non-exchange transactions (and the relative importance of those issues). It outlined the requirements of IPSAS 23 and feedback about IPSAS 23. It also considered ways in which this project could try to address those issues.
4. This paper summarizes the issues identified in the September 2015 paper, any feedback from the IPSASB on those issues, relevant developments in the project since that time and seeks feedback on the way forward.

#### IPSAS 23 Issues – Moving forward

5. The main issues noted in the September 2015 paper are outlined in Table 1 below. Work on some of these issues has progressed since that meeting, but there are a number of issues where little work has been done. The question is which issues should be prioritized for inclusion in the Consultation Paper.

**Table 1**

	<b>Issue and Comments</b>
Exchange vs non-exchange	<p><i>It can be difficult to classify certain revenue transactions as exchange or non-exchange.</i></p> <p>This issue is being addressed through the ongoing work on the modified performance obligation approach (see December 2015 and March 2016 agenda papers). The IPSASB is considering developing new requirements for some transactions which are currently classified as non-exchange but which have some form of performance obligation. These are the types of transactions which have been concerning constituents. This issue is already being addressed in the Consultation Paper (draft Chapter 2).</p>

	<b>Issue and Comments</b>
	<p>Even if the IPSASB develops a modified performance obligation approach there are still likely to be cases where judgment is required about which standard (or set of requirements) to apply. The IPSASB could consider requiring disclosures about the judgments applied.</p> <p><b>Options for moving forward:</b></p> <p>Should this work be prioritized for inclusion in the Consultation Paper?</p> <p>The alternative is that such disclosures could be considered at a later stage.</p>
<p>Interaction between IPSAS 23 and other standards</p>	<p><i>Any review of IPSAS 23 should examine the links between IPSAS 23 and other IPSASs.</i></p> <p><i>There is a need for guidance on the recognition of revenue in relation to rights to use assets for no, or nominal amounts (for example, the right to use office premises for a nominal rent).</i></p> <p>The September 2015 paper described how IPSAS 23 interacts with other standards such as leases and financial instruments. It identified three issues that could be considered as part of the revenue project and possible approaches to dealing with rights to use assets (for example, as services-in kind).</p> <ul style="list-style-type: none"> <li>(a) The recognition of a financial liability as a result of a non-exchange revenue transaction;</li> <li>(b) The recognition of revenue arising from a finance lease that includes a non-exchange component; and</li> <li>(c) The right to use assets.</li> </ul> <p><b>Options for moving forward:</b></p> <ul style="list-style-type: none"> <li>(a) Financial liability interaction: address in financial instruments project.</li> <li>(b) Finance lease interaction: Include a discussion of this issue in the Consultation Paper and seek feedback on possible solutions.</li> <li>(c) Rights to use assets: Include a discussion of this issue in the Consultation Paper and seek feedback on possible approaches.</li> </ul>

	<b>Issue and Comments</b>
Services in kind	<p><i>IPSAS 23 does not require the recognition of revenue for services in-kind, but these could be a significant part of the resources used by an entity</i></p> <p><b>Extract from September 2015 minutes:</b></p> <p>The IPSASB agreed that services in-kind should be re-examined taking into account the IPSASB's Conceptual Framework. There may be circumstances where services in-kind should be recognised, such as where there is control of those services and they can be measured reliably. An alternative to recognition in the financial statements is disclosure, or reporting services in-kind as part of service performance.</p> <p><b>Options for moving forward:</b></p> <p>Seek feedback in the Consultation Paper on whether recognition of some services in-kind should be required, and if so, which ones.</p>
Capital grants	<p><i>There are differing views about how to account for capital grants and a desire from some for consistent guidance on both the expense and revenue side of the transaction</i></p> <p>The IPSASB agreed (in September 2015) that capital grants should be re-examined under the performance obligation approach. This includes considering presentation and disclosure to help address some of the issues. The IPSASB commented "It is about how best to tell the performance story of the entity receiving the capital grant."</p> <p>Feedback on capital grants will be sought in the context of a modified performance obligation approach.</p> <p><b>Options for moving forward:</b></p> <p>Include capital grants in the proposed discussion of presentation options. Refer Table 2 below.</p> <p>Document the treatment of capital grants under GFS Reporting Guidelines.</p>

6. Other comments from constituents or matters noted by the IPSASB which have not been discussed in any detail yet are set out in Table 2. The IPSASB has previously noted that the Conceptual Framework will influence all of the proposals developed. For example, IPSAS 23 (paragraph 17) requires that in order for a recipient of resources to recognize a liability there has to be both a

performance obligation and a return obligation. It could be argued that this requirement leads to accounting that is not faithfully representative and may not provide relevant information.

**Table 2**

	<b>Issue and Comment</b>
Time requirements	<p><i>Some constituents have suggested that the IPSASB's consideration of deferred flows in the Conceptual Framework project should inform future thinking on non-exchange revenue</i></p> <p>This issue occurs with multi-year funding and, to a lesser extent, with any funding received in advance of the period in which it is required to be used.</p> <p><b>Options for moving forward:</b></p> <p>Agenda paper 11.6 seeks feedback from the IPSASB as to whether other resources and other obligations should be discussed in the Consultation Paper.</p> <p>Presentation options (noted below) might also be a way of providing information about how such revenue relates to specific periods.</p>
Presentation options	<p><i>Users might need additional information to understand fluctuations in surplus or deficit resulting from the receipt of large grants with no return conditions (which, under the current IPSAS 23 requirements would be recognized upfront)</i></p> <p>Changes to recognition and measurement may not be sufficient to address all of the issues that entities encounter in explaining their performance. Entities may still have some transactions that lead to fluctuations in reported surplus or deficit.</p> <p>Even if the IPSASB develops a modified performance obligation approach or looks at using other resources and other obligations, there are still likely to be some cases where entities have big fluctuations in reported surplus or deficit and might find guidance on presentation options helpful.</p> <p><b>Options for moving forward:</b></p> <p>Consider presentation options (such as reporting restricted net assets/equity) that might help entities explain their performance.</p>
Separate standards for taxes and transfers?	<p><i>Some constituents have suggested separate standards for taxes and transfers</i></p> <p><b>Options for moving forward:</b></p> <p>Defer discussion of the structure of future IPSAS(s) until a later stage of the project.</p>

	<b>Issue and Comment</b>
Tax revenue issues	<p>(a) <i>Whether to define taxes</i></p> <p>(b) <i>Taxable event</i></p> <p>(c) <i>Deciding at what point tax revenue should be recognized</i></p> <p>(d) <i>The need for information on total taxes levied for accountability purposes</i></p> <p>The IPSASB has previously agreed that tax revenue issues should be considered in the revenue project.</p> <p><b>Options for moving forward:</b></p> <p>The issues paper on statutory receivables (refer agenda paper 11.6) seeks feedback on issue (d) – it asks whether the IPSASB wants to develop standards-level guidance for statutory receivables.</p> <p>Do more research on tax revenue issues, including tax expenditures.</p>
Inconsistencies in IPSAS 23	<p>Some constituents have identified inconsistencies in relation to the treatment of advance receipts and other requirements in IPSAS 23.</p> <p><b>Options for moving forward:</b></p> <p>Defer work on these detailed issues (after the Consultation Paper).</p> <p>Seek general feedback in Consultation Paper.</p>

### Feedback Sought

7. We are seeking feedback on which of the above issues should be treated as a priority for the Consultation Paper and what type of work the IPSASB wants done on those issues.

## **REVENUE AND EXPENSES**

### **Statutory Receivables**

#### **Objectives of the Issues Paper**

1. The objective of this issues paper is to assist the IPSASB in forming preliminary views on whether to develop requirements for statutory receivables, and if so, what those requirements should be and where they should be located. The reason for forming a preliminary views on these matters is to seek feedback on any proposals for statutory receivables in the forthcoming Consultation Paper.
2. This paper:
  - (a) Documents the gaps in IPSASs in relation to statutory receivables;
  - (b) Note how some jurisdictions have addressed the need for guidance on statutory receivables;
  - (c) Note the concerns that have been raised about the initial recognition of statutory receivables in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and identifies possible changes to those requirements;
  - (d) Proposes that the IPSASB develops a standard dealing with statutory receivables; and
  - (e) Requests that the IPSASB form preliminary views on proposed requirements for statutory receivables, for the purpose of seeking feedback in the revenue and expenses Consultation Paper.

#### **Background**

3. In December 2013 the IPSASB directed staff to carry out research on statutory receivables and statutory payables. This discussion took place in the context of the project on public sector specific financial instruments. Staff reported back to the Board in June 2014 (refer agenda item 10.1, June 2014).
4. The June 2014 paper noted the types of transactions that can give rise to statutory receivables and payables, the extent to which IPSASs provide guidance on accounting for those transactions and the gaps in IPSASs. The IPSASB noted the work carried out by staff but did not make any decisions at that time. Shortly afterwards the IPSASB decided to limit the number of topics covered in the Consultation Paper on public sector specific financial instruments and decided not to discuss statutory receivables and payables in that Consultation Paper.
5. When the project brief for the revenue project was approved the Board noted that the project would include consideration of the *initial* recognition and measurement of statutory receivables. Board papers in September 2015 therefore identified some concerns that have been raised about the fair value measurement requirements in IPSAS 23 for initial measurement of statutory receivables.
6. During the IPSASB's revenue and expense discussions in March 2016 the IPSASB agreed that it would like to consider statutory receivable and payables further in the revenue and expenses project. The IPSASB requested an issues paper for the June 2016 meeting.

7. This paper focuses on statutory receivables. The issues associated with statutory payables (payables that arise from statute, regulation or other means) are being considered more generally as part of the work being done on non-exchange expenses.
8. We have incorporated the matters considered in the June 2014 paper in this paper.

### **What are Statutory Receivables?**

9. Statutory receivables are receivables that arise from legislation, supporting regulations or similar means.
10. In June 2014 the IPSASB noted that the following transactions could give rise to statutory receivables and payables:
  - (a) Taxes;
  - (b) Government transfers;
  - (c) Fines and penalties;
  - (d) Fees; and
  - (e) Social benefits.
11. The June 2014 agenda paper described the features of these transactions and explained why they could give rise to statutory receivables. Essentially it is because the transactions are non-contractual. The rights or obligations come from legislation, regulations or similar means – not contracts. The majority of these transactions are also non-exchange transactions. However, some, such as fees, could be either exchange or non-exchange.
12. When the IPSASB considered these examples in June 2014 it noted that any work on statutory receivables and payables should also consider transactions such as amounts payable to international organizations such as donations from governments and memberships in international organizations. Including consideration of such receivables would effectively expand the scope of this work to all *non-contractual* receivables, rather than statutory receivables. We have focussed on statutory receivables in this paper and do have some concerns that a broader scope might make it more difficult to progress this work. Nevertheless, before the IPSASB considers whether to limit the scope of this work to statutory receivables, it needs to know more about the form of transactions giving rise to receivables of international organizations, and whether they are within the scope of the existing financial instruments guidance or not. For example, in Canada, transactions with international organizations include loan agreements and investments in the share capital of international banks which would be within the scope of PS 3450 *Financial Instruments* and PS 3041 *Portfolio Investments*.
13. Some definitions and descriptions used by standard setters in relation to statutory receivables are set out below.

14. A definition of statutory receivables, and supporting discussion from a South African accounting standard<sup>1</sup> is:

Statutory receivables are receivables that:

- (a) arise from legislation, supporting regulations, or similar means; and
- (b) require settlement by another entity in cash or another financial asset.

...

AG2. Receivables in the public sector can arise from contracts or legislative requirements. Only those receivables that arise from legislation or an equivalent means, such as regulations, by-laws or other documents issued in terms of legislation, such as ministerial orders and cabinet or municipal council decisions, are considered “statutory receivables” and are within the scope of this Standard.

AG3. The public sector is a highly regulated environment with a number of overarching Acts or regulations governing the actions or behaviours of entities. ... Even if an entity’s operations are regulated by legislation, it does not mean that all transactions it enters into arise from statute. ... Transactions are only considered statutory where they are undertaken because of specific legislative requirements requiring or permitting an entity to enter into those transactions.

15. A description used in an Australian Accounting Standards Board (AASB) agenda paper is:<sup>2</sup>

For the purpose of this paper, the term ‘statutory receivables’ is defined as “receivables that are created as a result of transactions or events subject to statutory requirements imposed by governments”. Thus, statutory receivables include all receivables related to statutory charges, such as income tax, payroll tax, land tax, council rates, parking fines, traffic infringements and stamp duty.

16. A definition in Australian guidance is:

Statutory charges: Non-reciprocal charges imposed by Government.<sup>3</sup>

## Gaps in IPSASs for Statutory Receivables

17. The key message in this section of the paper is that there are gaps in IPSASs in relation to accounting for statutory receivables. More specifically:

- (a) The initial recognition and measurement of most statutory receivables is covered by IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. Some statutory receivables might be initially recognized and measured in accordance with IPSAS 9, *Revenue from Exchange Transactions*. Some constituents have expressed concern about whether the fair value requirements in IPSAS 23 are appropriate for statutory receivables.

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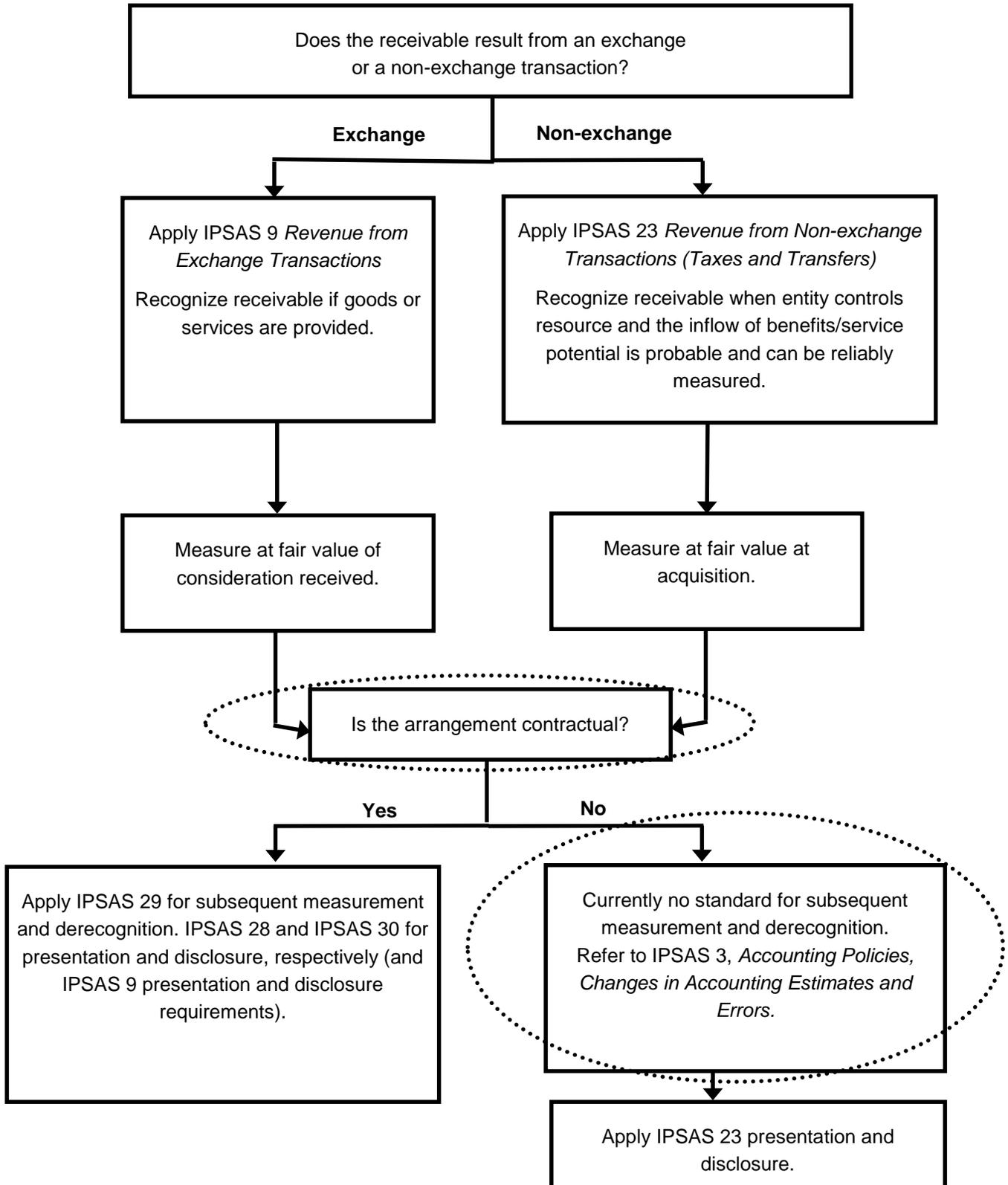
<sup>1</sup> South Africa Accounting Standards Board Standard of Generally Recognised Accounting Practice *Statutory Receivables* (GRAP 108).

<sup>2</sup> AASB agenda paper 9.2, December 2009

<sup>3</sup> Australian Commonwealth Government Resource Management Guide No. 125 *Commonwealth Entities Financial Statements Guide* (April 2015)

- (b) Subsequent measurement, derecognition and impairment of *non-contractual receivables* is not dealt with by IPSASs. Possible sources of guidance and the issues that arise when trying to use that guidance are discussed in this paper. In the absence of a standard, jurisdictions have developed their own policies.
18. The following decision tree, from the June 2014 agenda papers provides an overview of this gap. The paragraphs following the decision tree outline the requirements of the standards.

Diagram 1 IPSAS Requirements for Receivables



19. In the absence of an IPSAS that specifically applies to the subsequent measurement, derecognition and impairment of a statutory receivable, an entity would develop an accounting policy in accordance with IPSAS 3. This involves considering:
  - (a) The qualitative characteristics and constraints (IPSAS 3, paragraph 12);
  - (b) The requirements in IPSASs dealing with similar and related issues (IPSAS 3, paragraph 14(a));
  - (c) The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (IPSAS 3, paragraph 14(b)); and
  - (d) Recent pronouncements of other standard setting bodies and accepted public or private sector practices (IPSAS 3, paragraph 15).
20. Some would look to the standards on financial instruments (IPSASs 28-30) for guidance on subsequent measurement, derecognition and impairment. These standards provide guidance on accounting for *contractual receivables*. Although statutory receivables are not contractual (and therefore fall outside the scope of IPSAS 29), they are receivables that result in cash flows and therefore have some similarities to financial assets. Others consider that, because statutory receivables are not financial instruments, it is more appropriate to consider the impairment requirements in IPSAS 26 *Impairment of Cash-Generating Assets*. We consider the arguments put forward for using the impairment guidance in IPSAS 29 and IPSAS 26 to develop accounting policies for statutory receivables later in this paper.
21. Regarding presentation, there is a view in some jurisdiction that the disclosure requirements in IPSAS 30 are too onerous for statutory receivables. However, some other jurisdictions regard the credit risk disclosures as being appropriate for statutory receivables.
22. Assuming that the IPSASB decides to develop standard level guidance for statutory receivables, what should that guidance say? The next few sections of this issues paper are intended to assist the IPSASB in thinking about this. First we have looked at some existing guidance or approaches used in various jurisdictions and then we have provided some comments on the key topics that would need to be addressed in a standard on statutory receivables.

### **Examples of Guidance on Statutory Receivables**

23. We have looked at a range of guidance that has been issued, or developed for internal use by various jurisdictions and prepared a summary of findings. This is not an exhaustive summary, but it is likely that any jurisdiction considering how to account for statutory receivables would consider similar issues. Some examples of guidance on statutory receivables and discussions about accounting for statutory receivables follow.

#### South Africa

24. The Accounting Standards Board of South Africa issued Standard of Generally Recognised Accounting Practice (GRAP) 108 *Statutory Receivables* in September 2013. GRAP 108 establishes standards-level requirements and refers to national requirements that are generally consistent with IPSASs. We have provided a summary of GRAP 108 in Table 1 below.

<b>Table 1 Summary of GRAP 108 Statutory Receivables (South Africa)</b>	
<b>Initial recognition</b>	<p>In accordance with the relevant revenue standard (exchange or non-exchange).</p> <p>If outside the scope of these standards, use the definition of an asset and the recognition criteria for assets.</p>
<b>Derecognition</b>	<p>Three scenarios covered :</p> <ul style="list-style-type: none"> <li>(a) Rights are settled, expired or waived;</li> <li>(b) Transfer of substantially all of the risks and rewards; or</li> <li>(c) Retain some significant risk and rewards but transfer control to another party....</li> </ul> <p>The requirements are similar to the derecognition requirements in IPSAS 29 but they are much shorter and focus solely on statutory receivables.</p>
<b>Initial measurement</b>	<p>At “transaction amount” (defined term).</p> <p>This is the same as the amount determined on initial measurement under another standard.</p> <p>The <u>transaction amount</u> (for the purposes of this Standard) for a statutory receivable means the amount specified in, or calculated, levied or charged in accordance with, legislation, supporting regulations, or similar means).</p>
<b>Subsequent measurement</b>	<p>Use cost method (defined term).</p> <p>The <u>cost method</u> (for the purposes of this Standard) is the method used to account for statutory receivables that requires such receivables to be measured at their transaction amount, plus any accrued interest or other charges (where applicable) and less any accumulated impairment losses and any amounts derecognized.</p> <p>Assess for indicators of impairment at each reporting date.</p> <p>Measure any impairment loss as the difference between the estimated future cash flows (discounted if appropriate) and the carrying amount.</p> <p>Where the amount of the impairment is uncertain, estimate use the best estimate within the range In accordance with the Standard or GRAP on <i>Provisions, Contingent Liabilities and Contingent Assets</i>.</p>

**Table 1 Summary of GRAP 108 Statutory Receivables (South Africa)**

<b>Presentation and disclosure</b>	<p>An entity shall disclose information that enables users to evaluate the significance of statutory receivables on its financial position and performance. An entity shall provide sufficient information to permit reconciliation of information presented in the notes to the line items presented in the financial statements.</p> <p>The types of disclosures required include (these have been summarized):</p> <ul style="list-style-type: none"><li>(a) Information about the transaction, how it arises and how the amount is determined;</li><li>(b) The basis for impairment;</li><li>(c) The carrying amount of statutory receivables;</li><li>(d) Significant impairment losses;</li><li>(e) Collateral held; and</li><li>(f) An analysis of the collectability of statutory receivables.</li></ul>
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Canada

25. Canada has two public sector standards, PS 3510 *Tax Revenue* and PS 3410 *Government Transfers* that address initial measurement of taxes and transfer. PS 3510 requires taxes to be initially measured at net realizable value, even if the revenue is based on actual tax assessments as there is still uncertainty related to the outcome of any tax audits, appeals and court decisions. PS 3410 requires that transfers of monetary assets be measured at the amount stipulated in the law or regulation and transfers of capital assets be measured at the carrying amount of the transferred asset at the time of the transaction.
26. There is also general guidance in PS 1201 *Financial Statement Presentation*, paragraphs .49-.54, which is the guidance applied by Canadian public sector entities for statutory receivables. This general guidance covers both initial and subsequent measurement. Although statutory receivables are not financial instruments and are not in scope of PS 3450 *Financial Instruments*, they do meet the definition of financial assets in Canadian public sector standards. In Canada, measurement of statutory receivables is at the net recoverable amount for which a valuation allowance is recorded as necessary.

Australia

27. The Australian Accounting Standards Board (AASB) does not have a standard on statutory receivables. This resulted in various Australian governments forming differing views about the most appropriate accounting policies for statutory receivables (including the most appropriate standards to use as reference for developing policies). The AASB's standards incorporate the requirements of IFRSs. In April 2010 the AASB expressed a view that AASB 136 *Impairment of Assets* was more appropriate than AASB 139 *Financial Instruments: Recognition and Measurement* for assessing impairment of statutory receivables. Recent guidance issued by the Australian Commonwealth Government, Resource Management Guide No. 125 *Commonwealth Entities Financial Statements Guide* (April 2015), also takes that view.

## United States

28. The Federal Accounting Standards Advisory Board (FASAB) has issued guidance on receivables arising from taxes and duties and fines and penalties. Relevant extracts from Statement of Federal Financial Accounting Standards 7: *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (SFFAS 7) are shown below.

### **Excerpts from SFFAS 7**

#### Taxes and Duties

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53. **Accounts receivable** should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment processes to the extent the amount is measurable. This definition of accounts receivable from nonexchange transactions requires the standard for recognition of accounts receivable to be amended so that such receivables are not recognized on the basis of payment due dates but rather on the basis of the completion of the assessment processes.<sup>4</sup> Under such processes, assessments are enforceable claims for which specific amounts due have been determined and the person(s) or entities from whom the tax or duty is due have been identified. Assessments include both self-assessments made by persons filing tax returns or entry documents and assessments made by the collecting entities.
54. Assessments recognized as accounts receivable include tax returns filed by the taxpayer (or customs documents filed by the importer) without sufficient payments, taxpayer agreements to assessments at the conclusion of an audit or to a substitute for a return (or importer agreements to supplemental assessments), court actions determining an assessment, and taxpayer (or importer) agreements to pay through an installment agreement or through accepted offers in compromise. Receivables determined to be currently not collectable are included, but assessments where there is no future collection potential such as where the taxpayer (or importer) has been either insolvent or deceased for specified periods are not included. Accounts receivable, therefore, include only unpaid assessments made through the end of the period plus related fines, penalties, and interest. Accounts receivable do not include amounts received or due with tax returns received after the close of the reporting period or amounts that are compliance assessments<sup>5</sup> or pre-assessment work in process.

#### Fines and Penalties

61. Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. They may be imposed by the entities collecting taxes and duties, or by other government entities. The time when a claim to resources arises will depend on the nature of the fine and the associated legal and administrative processes. Some examples of conditions that, depending on the circumstances, could establish a legally enforceable and measurable claim include (1) the date by which an individual may contest a court summons

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<sup>4</sup> SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, para. 41, states that "a receivable should be recognized . . . based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due) . . ." Under the revenue standard, past due taxes are not recognized on the date they are due, but rather on the date when tax returns are received without sufficient payment or legally enforceable claims against non-compliant taxpayers are established through enforcement processes

<sup>5</sup> Customs refers to "compliance assessments" as protested assessment amounts.

expires, (2) the offender pays the fine before a court date, or (3) the court imposes the fine. An allowance for uncollectible accounts should, as in the case of taxes and duties, be recognized as a revenue adjustment and determined in accordance with other standards.<sup>6</sup> The allowance should reduce the gross amount of the receivable and revenue to its net realizable value, based on the criterion that losses should be recognized to the extent it is probable (more likely than not) that some or all of the receivables will not be totally collected.

**Excerpts from Financial Report of the United States Government - 2015**

Note 3 Accounts and Taxes Receivable, Net

<b>Accounts and Taxes Receivable as of September 30, 2015, and 2014</b>		
<b>Accounts receivable....</b>		
<b>Taxes receivable:</b>	<b>2015</b>	<b>2014</b>
Gross taxes receivable	177.4	161.7
Allowance for uncollectible amounts	<u>(133.1)</u>	<u>(118.7)</u>
Taxes receivable, net.	<u>44.3</u>	<u>43.0</u>

Taxes receivable consist primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed or a court has determined the assessments are owed. Taxes receivable do not include unpaid assessments when taxpayers or a court have not agreed that the amounts are owed (compliance assessments) or the government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (write-offs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible. The allowance for uncollectible amounts is based on projections of collectibles from a statistical sample of unpaid tax assessments.

Also reported as required supplementary (unaudited) information:

**Tax Assessments**

The Government is authorized and required to make inquiries, determinations, and assessments of all taxes that have not been duly paid. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as enforcement programs such as examination, under-reporter, substitute for return, and combined annual wage reporting. Under federal accounting standard, unpaid assessments are categorized as taxes receivable if taxpayers agree or a court has determined the assessments are owed. If neither of these conditions are met, the unpaid assessments are categorized as compliance assessments. Assessments with little or no future collection potential are called write-offs. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the Government. There is, however, a significant difference in the collection potential between compliance assessments and receivables. Compliance assessments and pre-assessment work in process are \$82.1 billion and \$88.8 billion for fiscal years 2015 and 2014, respectively. The amount of allowance for uncollectible amounts pertaining to compliance assessments cannot be reasonably estimated, and thus the net realizable value of the value of the pre-assessment work-in-process cannot be determined. The amount of assessments that agencies have statutory authority to collect at the end of the period but that have been written off and excluded from accounts receivable are \$138.0 billion for both fiscal years 2015 and 2014.

<sup>6</sup> SFFAS No. 1, para. 44-51.

New Zealand

29. Prior to 2014/15 the Government of New Zealand developed accounting policies for sovereign receivables based on IFRSs. More recently the accounting policies for sovereign receivables have been based on the requirements in IPSAS 23.
30. In 2008, under IFRSs, the New Zealand Government developed the following accounting policy for sovereign receivables:
- “Receivables from taxes, levies and fines (and any penalties associated with these activities) as well as social benefit receivables which do not arise out of a contract are collectively referred to as sovereign receivables.
- Sovereign receivables are initially assessed at nominal amount or face value; that is, the receivable reflects the amount of tax owed, levy, fine charged, or social benefit debt payable. These receivables are subsequently adjusted for penalties and interest as they are charged, and tested for impairment. Interest and penalties charged on tax receivables are presented as tax revenue in the statement of financial performance.”
31. For certain receivables, such as fines, it was expected a percentage would not be collected based on past history because entities/citizens would be unable or unwilling to pay the amount owed, or estimated to be owed. Under the accounting policy this was recognized as a day one impairment expense (which also required an appropriation).
32. In 2009 the New Zealand Treasury also issued guidance on the treatment of tax receivables which outlined the following approach to tax receivables:
- (a) Tax receivables should be recognized at the amount of the tax owed, The guidance stated that the amount of tax owed was equal to fair value, and expressed the view that this was consistent with NZ IAS 39 and IPSAS 23. The tax obligation was regarded as being analogous to the transaction price and no concessionary terms or conditions exist in most cases to suggest that fair value would be less than face value.
  - (b) Subsequent re-estimation of the tax owed (or estimated to be owed) is necessary because of the gap between the tax event and the tax filing date. Changes to assessments or expectations regarding the outcome of taxes in dispute is an adjustment to tax revenue.
  - (c) Tax receivables should be subsequently adjusted for any penalties and interest as charged, and should be assessed annually for impairment in accordance with NZ IAS 36 *Impairment of Assets*.
  - (d) Tax receivables are short term, so there is no need for discounting.
33. Following the adoption of PBE Standards based on IPSASs in 2014/15 there have been debates about how the requirements in IPSAS 23 for initial measurement at fair value should be applied to statutory receivables and revenue. The differing views are as follows:
- (a) One view was that initial fair value of statutory receivables is the best estimate of the inflows arising to the government, represented by the discounted cash flows expected to be received. Under this fair value approach, statutory receivables and revenue are initially recognized at the discounted value, with no day one impairment expense for amounts expected to be uncollectible. Proponents of this view argued that in one unusual case, where only 3% of the fine is actually collected, that it would be misleading to show 100% as revenue and 97% as an

impairment expense on initial recognition. It was acknowledged that this extreme scenario is not common in New Zealand.

- (b) The alternative view was that, for the majority of fines and taxes, initial recognition of fines at face value provides useful information, is more transparent and better meets the objective of accountability. Under this alternative view the amount expected to be uncollectible would be shown as an impairment. Proponents of this view (the face value approach), argued that sovereign power is exercised through the use of constitutionally and legally sanctioned authority. If it is assumed that tax payers and fines-payers are willing to abide by constitutionally and legally sanctioned processes, then it can be argued that they are willing to pay the amount levied. On that basis when applying the definition of fair value (“the amount at which an asset could be exchanged, or liability settled, between knowledgeable, willing parties in an arm’s length transaction”), the initial fair-value of receivables arising from the exercise of sovereign power should be the amount owed, or estimated to be owed because both parties are knowledgeable and willing to transact at that initial amount.
34. The debate in New Zealand has focused on whether fair value is the same as face value, or whether it is face value less amounts that are regarded as being uncollectable from day 1.<sup>7</sup> The latter approach was taken on transition to the new PBE Standards (based on IPSASs) in the 2014/15 financial statements of the New Zealand Government, because it was considered that recording sovereign revenue at its face value would not comply with IPSAS 23. However, there continue to be concerns about whether the requirements in IPSAS 23 are appropriate for demonstrating accountability for the initial sovereign revenue and the collection of that revenue.

#### **Matters for Consideration**

1. Is the IPSASB aware of any other relevant guidance on statutory receivables or current practices that could be useful?
2. Could members and observers please share examples of international organization receivables (both those that would fall within the standards on financial instruments and those that would not) and any particular difficulties in accounting for these receivables.

#### **Initial recognition**

35. The initial recognition of revenue associated with transactions giving rise to statutory receivables is addressed in IPSAS 9, *Revenue from Exchange Transactions* and IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. Although most statutory receivables will be initially recognized in accordance with IPSAS 23, for the sake of completeness we have included a discussion of IPSAS 9 first. The purpose of this section is to look at the existing requirements in the revenue standards and see whether any changes would be appropriate. At this stage we are not looking at the most appropriate location for these requirements (we will seek IPSASB’s views about the possible location of guidance later in this paper).

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<sup>7</sup> For those interested in the potential application of guidance on trade receivables in IFRS 9 *Financial Instruments* to statutory receivables, there would be a need to consider expected credit losses. Those that are regarded as uncollectable from day 1 would obviously have to be identified. However, IFRS 9 might require the identification of additional expected credit losses.

36. Requirements in IPSAS 9 which are relevant to the initial recognition of statutory receivables include:
- (a) Paragraph 14 which states that “Revenue shall be measured at the fair value of the consideration received or receivable”; and
  - (b) Paragraph 16 which states “.when the inflow or cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. ...When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest”.
37. IPSAS 9 establishes criteria for the recognition of revenue. Although there are separate sections dealing with revenue from the rendering of services and revenue from the sale of goods, both sections establish revenue recognition criteria that refer to reliable measurement and the probability of the entity receiving the inflow (IPSAS 9, paragraphs 19 and 28).
38. Requirements in IPSAS 23 which are relevant to the initial recognition of statutory receivables include:
- (a) Paragraph 42 which states that “An asset acquired through a non-exchange transaction shall initially be measured at its fair value as at the date of acquisition”;
  - (b) Paragraph 59 which states “An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met”; and
  - (c) Paragraphs 67-70 which deal with the measurement of assets arising from taxation transactions. Paragraph 67 refers to the fair value measurement required by paragraph 42 and explains that assets arising from taxation transactions are measured at the best estimate of the inflow of resources to the entity. Paragraph 67 also states that “The accounting policies for these assets will take account of both the probability that the resources arising from taxation transactions will flow to the government, and the fair value of the resultant assets”. Paragraph 60 discusses changes in estimates of current period revenue in future periods due to the use of statistical models and notes that such changes are dealt with in accordance with IPSAS 3, *Accounting policies, Changes in Accounting Estimates and Errors*.
39. As noted above, there is some debate about whether the initial measurement of revenues such as taxes and fines at fair value is appropriate. There are concerns that this does not allow an entity to show the amount of taxes, fees or fines assessed or levied, but which are not expected to be collected. Some arguments in favour of recognizing the total amount assessed or levied as revenue, and the amounts written off as expenses, are as follows:
- (a) The total amount has been assessed or levied in accordance with a statute. The public sector entity that is responsible for collecting the revenue should be held to account for the total.
  - (b) The amount written off on day 1 because it is uncollectable is information that is useful for decision making. If large amounts are written off on day 1 it might be appropriate to review the legislation or regulation, or to review the collection procedures.
  - (c) In contrast to financial instruments which can generally be sold, statutory receivables may not be able to be sold.
40. Given that the IPSASB is proposing to issue new and improved revenue standards, it is appropriate to reconsider the initial measurement of statutory receivables and statutory revenue in accordance with the new/improved revenue standards. It is also appropriate to consider the objectives of financial

reporting, the qualitative characteristics and the measurement bases in the Conceptual Framework. The potential measurement bases for assets described in the Conceptual Framework are historical cost, market value, replacement cost, net selling price and value in use.

41. In developing any new requirements for initial and subsequent measurement of statutory receivables the Board would consider these measurement bases, together with the qualitative characteristics. A fundamental question is whether the IPSASB considers that statutory revenue should be *initially recognized* at the amount to which a government expects to be entitled, which would not reflect any adjustments for amounts that the entity might not be able to collect because the tax or fine payer is unable, or unwilling to pay. As can be seen from the following comments, this approach would not seem to be possible under any of the measurement bases in the Conceptual Framework.
42. The measurement bases in the Conceptual Framework, together with some comments on their potential application to statutory receivables follow.
  - (a) Historical cost: *The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.* There is generally no consideration given to acquire or develop statutory receivables. Measurement at an historic cost of zero would not be appropriate and is the reason why the IPSASB established the fair value requirements for non-exchange transactions in various IPSASs (refer IPSAS 23 paragraph BC16 for an explanation of the IPSASB's views on this point).
  - (b) Market value: *The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.* This measurement base is close to the current definition of fair value used in IPSASs, and, as noted earlier in this paper, IPSAS 23 currently requires that assets acquired through non-exchange transactions be measured at their fair value as at the date of acquisition. More specifically, IPSAS 23 paragraph 67 states that "Assets arising from taxation transactions are measured at the best estimate of the inflow of resources to the entity". One problem with requiring that statutory receivables be measured at market value is the reference to "exchange". Although some governments can sell or securitize statutory receivables, other cannot. The concept of market value works if one thinks of it as the amount for which an entity could exchange a statutory receivable, assuming that it has the right to do so. This measurement base also implies that the initial recognition of statutory receivables and revenue is what the government expects to be entitled less any adjustments for amounts that the government expects not to collect because the levy payer is unable or unwilling to pay.
  - (c) Replacement cost: *The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.* This definition works for assets that are constructed. It is not appropriate for receivables, most of which will be settled in cash.
  - (d) Net selling price: *The amount that the entity can obtain from the sale of the asset, after deducting the costs of sale.* This is an entity specific version of market value. Because most receivables are settled in cash, it does not seem necessary to consider entity specific factors. Market value would be more appropriate than net selling price.
  - (e) Value in use: *The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity*

will receive from its disposal at the end of its useful life. This definition appears to be most relevant for assets that will be held and used by an entity. An entity does not “use” statutory receivables in this sense.

43. As noted throughout this paper, some are of the view that initial recognition of statutory receivables should be at the amount the government expects to be entitled (that is, face value or transaction value). There is usually no market for these receivables so it is difficult to recommend market value as the best basis. Following a day 1 impairment, the carrying value would be aligned with the market value measurement base, but it would have taken two steps to get to that point. It might be necessary to either amend the definition of market value in the Conceptual Framework or introduce a new measurement basis for these types of transactions.
44. So far we have focused solely on the measurement bases in the Conceptual Framework. In considering the most appropriate requirements for initial recognition of statutory receivables one the IPSASB would also consider user needs, the information required for accountability purposes and the qualitative characteristics (including relevance).

#### **Matters for Consideration**

3. What does the IPSASB consider to be the most appropriate requirement for the initial recognition of statutory receivables? The two options considered in this paper are (a) transaction value (followed by a day 1 impairment) and (b) market value.

#### **Subsequent measurement, derecognition and impairment**

45. Neither IPSAS 9 nor IPSAS 23 deal with the subsequent measurement, derecognition or impairment of receivables. As shown in the decision tree in Diagram 1, IPSASs currently address subsequent measurement, derecognition and impairment of financial assets (contractual receivables are contractual rights to receive cash or another financial asset) but not statutory receivables (which are non-contractual). In the absence of a standard on statutory receivables people have formed differing views about the most appropriate sources of guidance on subsequent measurement and impairment. Some look to IPSAS 29 and some to IPSAS 26.
46. If an entity accounts elects to account for a statutory receivable in accordance with IPSAS 28, *Financial Instruments: Presentation* and IPSAS 29, *Financial Instruments: Recognition and Measurement* it would:
  - (a) Classify the receivable in the category “loans and receivables”;
  - (b) Initially recognize the receivable at fair value plus transaction costs (IPSAS 29, paragraph 45);
  - (c) Subsequently account for the receivable at amortized cost using the effective interest method (IPSAS 29, paragraph 48). The amortized cost of a financial asset is the initial cost less the sum of principal repayments, cumulative amortization of premiums/discounts and cumulative impairment write-downs (defined in IPSAS 29 paragraph 10). The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability. The effective interest method is defined in IPSAS 29 paragraph 10); and
  - (d) Recognize impairment losses when they are incurred. IPSAS 29 sets out examples of loss events that may provide objective evidence that a financial asset or group of assets is

impaired. (Extracts from IPSAS 29 paragraphs 67-74 are included in an appendix to this paper).

47. This paper refers to the requirements in IPSAS 29. The IPSASB has a project to develop a standard based on IFRS 9 *Financial Instruments* but has yet to consider the requirements of IFRS 9 in any detail. An education session on IFRS 9 will take place at this meeting (refer agenda item 8). Both the classification requirements and impairment requirements in IFRS 9 differ from those in IPSAS 29. For example, IFRS 9 refers to financial assets being classified as “subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss”. In addition, the impairment requirements in IFRS 9 are based on an expected loss model rather than the incurred loss model in earlier standards.
48. At this stage it is too early to assess the most appropriate impairment model for statutory receivables as the IPSASB needs to further consider the applicability of the expected loss model versus the incurred loss model in the proposals to update the financial instruments standards. This needs to precede consideration of their applicability to statutory receivables. The more general question that can be debated now is whether statutory receivables are similar enough to receivables within the scope of IPSAS 29/IFRS 9 to be accounted for in the same way. This is discussed in more detail below. The IPSASB might also want to seek constituents’ views on this issue.
49. The rights associated with a statutory receivable arise from legislation or regulations, not contracts. They are therefore *not* financial assets and are outside the scope of IPSAS 28 and IPSAS 30. This has led some to argue that IPSAS 26 is the most appropriate source of guidance to develop an impairment policy for statutory receivables. An entity accounting for statutory receivables using the impairment requirements in IPSAS 26 would:
  - (a) Develop its own policy for initial recognition of the receivable (not covered by IPSAS 26);
  - (b) Assess at each reporting date whether there is any indication that an asset may be impaired. There are a number of indicators. If any such indication exists, the entity shall estimate the recoverable amount of the asset and recognize an impairment loss for the amount by which the carrying amount of the asset exceeds its recoverable amount;
    - (i) The recoverable amount is the higher of the asset’s fair value less costs to sell and its value in use. In practice, fair value less costs to sell is not relevant if a government does not contemplate selling the receivables.
    - (ii) Value in use is the present value of estimated future cash flows expected to be derived from the continuing use of the asset, and from its disposal at the end of its useful life; and
  - (c) Recognize an impairment loss in surplus or deficit.
50. Extracts from IPSAS 26 (that would be considered by an entity developing a policy having regard to the guidance in IPSAS 26) are included in an appendix to this paper.
51. We are seeking feedback on which of these two approaches to impairment (financial instruments approach versus IPSAS 26 approach) the IPSASB considers to be most appropriate for statutory receivables. Points that are made for and against using these two standards to develop impairment policies for statutory receivable are set out below. Neither standard provides a perfect solution and the IPSASB may end up developing a simplified approach based on the requirements in one of these standards.

52. Arguments made in support of using IPSAS 29 to develop an impairment policy for statutory receivables:
- (a) The characteristics of statutory receivables are more like financial instruments than the assets to which IPSAS 26 applies. Although they are not contractual (they do not involve willing parties entering into an arrangement), they do appear very similar in substance to financial instruments. Statutory receivables are legally enforceable – which is one of the key requirements of contractual financial instruments.
  - (b) IPSAS 26 was predominantly written for property, plant and equipment, intangible assets and goodwill. The unit of account in IPSAS 26 is either the individual asset or cash-generating unit but receivables are often better assessed using a portfolio approach. IPSAS 29 provides for a portfolio approach to impairment testing which is a reasonable basis for assessing the impairment of significant numbers of statutory receivables. It is not clear whether IPSAS 26 permits impairment testing to be conducted on a portfolio basis (although some consider that IPSAS 26 paragraph 36 which refers to “estimates, averages and computational shortcuts” indicates that this is possible).
53. The main argument made in support of using IPSAS 26 to develop an impairment policy for statutory receivables is that the amortized cost requirements in IPSAS 29 are inappropriate for statutory receivables. The amount due is often revised in subsequent periods which makes it difficult to apply amortized cost. The constant revision of the original amount due occurs because taxes may be recognized when the taxable event occurs, but the initial assessment of the amount due often involves estimates and judgements. As better information becomes available over time, that initial amount changes. The effective interest rate approach does not work when both the amount owing is subject to change and there is no set “original effective interest rate”.
54. Those that support referring to IPSAS 26 for guidance acknowledge that it can be a bit awkward to apply by analogy (for example, the unit of account is awkward), but they consider that the recoverable amount principle in IPSAS 26 is a useful guide when determining the carrying value of statutory receivables.
55. Those that would support an IPSAS 26 approach focus on the differences between statutory receivables and receivables in the scope of IPSAS 29/IFRS 9. For example, tax receivables differ from other loans and receivables in a number of ways:
- (a) They arise from non-contractual and non-exchange transactions.
  - (b) The tax obligation and resulting assets are unique and are governed by rules as set out in tax legislation.
  - (c) The obligation arises as taxable activity is undertaken, yet the amount that is actually due may be determined some time after the taxable event. This means significant estimates and judgments are required to quantify the receivable and the amount owed can be subject to considerable revision.
  - (d) Penalties and interest charges automatically apply under the rules but will change and can be reversed when the actual receivable is known.
  - (e) Estimation and re-estimation of a taxpayer's obligations can occur over many periods with related interest and penalties similarly updated. These changes are not impairments – they are reassessments of the amount originally expected to be due.

- (f) Tax receivables are not a commercial debt. Governments may not be able to sell or otherwise transfer taxes receivable.
56. Although these factors can be used to argue that statutory receivables should not be subject to the impairment requirements in IPSAS 29/IFRS 9, some aspects of those requirements, or simplified versions of those requirements might be workable for statutory receivables. For example, the models used by some governments to assess impairment of statutory receivables might be closer to expected loss models than incurred loss models.

## **Interest and discount rates**

### Interest

57. Some statutory receivables are subject to interest if they are not paid by the due date. As noted earlier, transactions giving rise to statutory receivables may be classified as exchange or non-exchange.
58. IPSAS 9 contains requirements for accounting for revenue from exchange transactions. It requires that interest be recognized on a time proportionate basis that takes into account the effective yield on the asset. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expressed over the life of the asset to equate to the initial carrying amount of the asset. These requirements are appropriate where the initial amount due is known and is not subject to a lot of reassessment.
59. IPSAS 23 does not contain any requirements for accounting for interest on non-exchange transactions. This means that there is a gap in guidance. GRAP 108 addresses this issue. It requires that the initial amount recognized subsequently be adjusted for interest or other charges that may have accrued on the receivable. It notes that interest rates are often specified in legislation or regulation and states that accrued interest is calculated using the nominal interest rate.

### Discount rates

60. Most standards dealing with assets require that where there is a time gap between initial recognition and the receipt of the asset, that the expected future amount be discounted to its present value. In practice, some governments do not bother to discount statutory receivables because they are short term or because the government charges interest on unpaid amounts.
61. IPSAS 23 does not contain any detailed guidance on discounting and discount rates. It does refer briefly to discounting, but not in the context of statutory receivables. IPSAS 23 states:
- (a) Bequests: discounting may be required if receipt of a bequest is delayed (paragraph 92); and
  - (b) Transfer revenue: Monetary assets are measured at their nominal value unless the time value of money is material, in which case present value is used, calculated using a discount rate that reflects the risk inherent in holding the asset (Non-integral guidance, paragraph 7).
62. GRAP 108 requires that "...where the effect of the time value of money is material, an entity discounts the estimated future cash flows using a rate that reflects the current risk free rate and, if applicable, any risks specific to the statutory receivable, or group of statutory receivables, for which the future cash flow estimates have not been adjusted."
63. We consider that any standards-level guidance on subsequent measurement of statutory receivables should deal with discounting, along the lines of the requirements in GRAP 108. The implications of

the financial instruments update project would also need to be considered in relation to any discount rate proposals.

## **GFS alignment**

64. The consideration of GFS issues is preliminary. If the IPSASB proceeds to develop guidance on statutory receivables there are a number of issues that will need to be considered. At this point we have highlighted some of the issues. We understand that some of these issues have also been identified in other projects such as social benefits and public sector financial instruments.

### Classification

65. In this issues paper the classification of a receivable as “statutory” depends on the classification of revenue/expense (that is, the receivable is statutory if it arises “from legislation, supporting regulations or similar means”).
66. GFSM 2014 does not use the term “statutory”. Therefore, we would need to assess the classification of receivables from a GFSM 2014 perspective. Any classification differences between GFSM 2014 and IPSASs would give rise to differences in recognition and measurement. For example, GFSM 2014 classifies revenue as taxes (based on which the tax is levied) and revenue other than taxes. We should therefore compare the definitions of tax in GFSM 2014 (para. 5.23) and IPSASs and see if there is any fundamental difference that might give rise to a different classification.
67. Classification is important because, for example, according to GFSM 2014 paragraph 5.23 “If a tax on payroll or workforce is designated for use in a social security scheme, then it is classified as a social security contribution (see paragraphs 5.45 and 5.96). Otherwise, it is classified under taxes on payroll and workforce. Taxes also exclude compulsory payments receivable by government, as contributions to employment-related pension schemes. Since these compulsory contributions are associated with the expectation of future benefits payable, they are not tax revenue receivable, but rather recorded as the incurrence of a pension entitlement liability (see paragraphs 9.63–9.67).”
68. This issue means that it will be necessary to clearly identify which “statutory” receivables will be in the scope of this work, so that we can identify the relevant GFSM 2014 treatment.
69. It is worth noting that differences between the classification of transactions for the purpose of GFSM and IPSASs have also been identified in other projects, and we may need to keep an eye on these to develop consistent approaches to dealing with the differences.

### Recognition

70. According to GFSM 2014 paragraphs 5.12 and 5.13 “income taxes and social contributions based on income should be attributed to the period in which the income is earned, even though there may be a significant delay between the end of the reporting period and the time at which it is feasible to determine the actual liability of the taxpayer. Conceptually, when using the accrual basis of recording, the time between the moment a revenue transaction accrues and the payment is received (or made in the case of refunds) is bridged by recording a transaction in financial assets or liabilities (see paragraph 7.224).”
71. According to GFSM 2014, receivables that arise from taxes are also financial assets. However, they do not meet the definition of financial assets in IPSASs. This is an existing difference between GFS and IPSASs, but is nevertheless a fundamental difference. We are not sure how this issue could be addressed.

## Measurement

72. As noted above, it will be necessary to clearly identify which receivables will be in the scope of this work, so that we can identify the relevant GFSM 2014 measurement requirements.
73. The Government Finance Statistics Manual 2014 (GFSM 2014) acknowledges some of the difficulties associated with the recognition and measurement of statutory receivables (see paragraph 5.19–5.20 below). The guidance in the GFSM appears to require initial recognition based on best estimates of what will be corrected, subsequent impairment as more information comes to light and the possibility of additional revenue recognition for tax amnesties.

### **Extract from GFSM 2014**

- 5.19 Furthermore, in some countries, and for some taxes, the amounts of taxes eventually paid may diverge substantially and systematically from the amounts due to be paid. It would be inappropriate to accrue revenue for an amount that the government unit does not realistically expect to collect. The amount that is realistically expected to be collected may sometimes be influenced by tax amnesties. Governments use tax amnesties to capture some of the taxes accrued but unpaid, to speed up payment of taxes and to capture revenue from transactions or events that have previously escaped the attention of the tax authorities. The time of recording and measurement of revenue arising from such tax amnesties depends on the exact nature of the amnesty granted and whether the revenue has been previously accrued or not. The case of adjusting for underestimation or overestimation of tax revenue is discussed below.
- 5.20 It is typical that some of the taxes and social insurance contributions that have been assessed and accrued will never be collected. Thus, the difference between estimates based on these assessments and expected collections represents a claim that has no real value and should not be recorded as revenue. If transactions are recorded for such taxes (and other revenue) that overestimate the amount of revenue receivable, a correction should be recorded in the GFS framework. This requires an adjustment that allows the excessive increase in net worth previously recorded to be corrected.<sup>9</sup> In keeping with the accrual basis of recording (see paragraph 3.79), such an adjustment should occur in the period in which the overestimation of receivables occurred. However, in cases where it is not possible to identify the time of the overestimation, the adjustment is recorded when the need for the adjustment is identified. As such, a correction to reduce revenue, with a corresponding correction (reduction) in other accounts receivable (3208) should be recorded. The amount of taxes and social insurance contributions that is recorded as revenue should be the amount that is realistically expected to be receivable. The actual collection, however, may be in a later period, possibly much later.

## **Options for Developing Guidance on Statutory Receivables**

74. The first question to be addressed is whether the IPSASB agrees that it should establish standards-level requirements to deal with statutory receivables.
75. If the IPSASB does not develop standards-level requirements for statutory receivables entities would continue to develop policies having regard to IPSAS 3. However, the absence of guidance has led to differing views and differing policies.
76. If the IPSASB develops standards-level requirements for statutory receivables the question is where the requirements should be located. Some members of the Task-Based Group have suggested that

it is too early to form a view on the location of any guidance. In the June 2014 papers staff identified two options for addressing the gaps in IPSAS in relation to accounting for statutory receivables. These two options were:

- (a) Approach one—update IPSAS 23 to address the gap which has been identified.
- (b) Approach two—create a new standard similar to GRAP 108, *Statutory Receivables* which refers to the initial recognition requirements in other standards and deals with matters such as derecognition and subsequent measurement.

77. In 2014 staff recommended approach two. This would address the identified gap in the IPSAS literature for subsequent measurement and derecognition of non-contractual receivables. It would also acknowledge that revenue from statutory receivables might be initially recognized in accordance with IPSAS 9 or IPSAS 23.
78. The IPSASB does not need to form a view at this stage on how any standards-level requirements would be promulgated. It may be better to wait until the proposals are developed to determine whether a separate standard is required or whether the guidance should be incorporated into IPSAS 23 and possibly IPSAS 9. This may depend on how the extent of the proposals. In the meantime it would be helpful for staff working on different projects to know if the IPSASB has any views on this.

**Matters for Consideration**

- 4. Does the IPSASB agree that it should establish standards-level requirements to deal with statutory receivables?
- 5. Does the IPSASB have a view on whether standards-level requirements on subsequent measurement of statutory receivables should be:
  - (a) located in the revenue standards(s); or
  - (b) located in a separate standard?

79. If the IPSASB agrees that it should create a new standard to deal with statutory receivables, the Consultation Paper on revenue and expenses would provide a good opportunity to seek feedback from constituents on that proposal. We appreciate that the IPSASB has not previously debated some of these issues, but we think that constituents would find it easier to comment on specific proposals than a general question. We have therefore identified some proposals on which the IPSASB could seek feedback in the Consultation Paper.
80. The proposals in Table 2 are presented for consideration by the IPSASB. If the IPSASB does not agree with these proposals we would like feedback on what the IPSASB would prefer to say in the Consultation Paper.

**Table 2: Possible Consultation Paper Proposals on Statutory Receivables**

Introduction

Acknowledge the gaps in IPSASs in relation to statutory receivables.

Express intention to develop a separate standard dealing with statutory receivables.

<b>Table 2: Possible Consultation Paper Proposals on Statutory Receivables</b>
<p>Definition</p> <p><i>The IPSASB could seek feedback on a definition in the CP or it could choose to describe statutory receivables and leave the definition until the ED stage.</i></p> <p>Option 1: Statutory receivables are those that are created as a result of transactions or events subject to statutory requirements imposed by governments.</p> <p>Option 2: Statutory receivables are those that:</p> <ul style="list-style-type: none"> <li>(a) arise from legislation, supporting regulations, or similar means; and</li> <li>(b) require settlement by another entity in cash or another financial asset.</li> </ul>
<p>Initial recognition and measurement</p> <p><i>There are two proposals put forward for discussion at this meeting</i></p> <p>Option A:        Initial recognition at transaction value (or face value) and day 1 impairment to market value. That is, if 80% of a tax was expected to be collected, 20% would be recognized as an impairment on day 1.</p> <p>Option A:        Initial recognition at <i>market value</i> (as defined in the Conceptual Framework), with some additional disclosures (see the disclosure proposals). This would be similar to the fair value requirement in IPSAS 23.</p>
<p>Derecognition</p> <p>Propose to base requirements on GRAP 108 which covers three scenarios leading to derecognition:</p> <ul style="list-style-type: none"> <li>(a) Rights are settled, expired or waived;</li> <li>(b) Transfer of substantially all of the risks and rewards; or</li> <li>(c) Retain some significant risk and rewards but transfer control to another party....</li> </ul> <p>The requirements are similar to the derecognition requirements in IPSAS 29 but they are much shorter and focus solely on statutory receivables.</p>
<p>Subsequent measurement</p> <p>Propose that the amount initially recognized (subject to discussion of options A and B above) is then treated as the initial cost.</p> <p>Propose to measure at “cost” less impairment.</p> <p>Impairment guidance – <i>seeking feedback from the IPSASB</i> – possible options are discussed above.</p>
<p>Interest on statutory receivables</p> <p>Propose that the amount initially recognized subsequently be adjusted for interest, with accrual interest calculated using the nominal interest rate (as per GRAP 108).</p>
<p>Discount rates</p> <p>Propose that future cash flows be discounted using a rate that reflects the current risk free rate and, if applicable, any risks specific to the statutory receivable, or group of statutory receivables, for which the future cash flow estimates have not been adjusted (as per GRAP 108).</p>

<b>Table 2: Possible Consultation Paper Proposals on Statutory Receivables</b>
<p>Disclosure</p> <p>Use the disclosures in GRAP 108 as a starting point.</p> <p>Require fewer disclosures than IPSAS 30.</p> <p>Under Option A: Propose that the difference between amounts assessed or levied and the amount initially recognized be disclosed (either on the face of the statement or in the notes).</p>
<p>GFS Alignment</p> <p>Include a comment that the development of standards-level requirements, along the lines of GRAP 108, would appear to be broadly in line with the GFSM 2014.</p>
<p>Links with Other Projects</p> <p>Propose that receivables arising out of a modified performance obligation approach would fall within the scope of the financial instrument standards (currently IPSAS 29).</p>

**Matter for Consideration**

6. Which of these possible proposals does the IPSASB consider should be included in the revenue and expense project Consultation Paper?

## Summary of Matters for Consideration

81. The matters for consideration throughout the issues paper are repeated here.

### Matter(s) for Consideration

7. Is the IPSASB aware of any other relevant guidance on statutory receivables or current practices that could be useful?
8. Could members and observers please share examples of international organization receivables (both those that would fall within the standards on financial instruments and those that would not) and any particular difficulties in accounting for these receivables.
9. Does the IPSASB agree that it should establish standards-level requirements to deal with statutory receivables?
10. Does the IPSASB have a view on whether standards-level requirements on subsequent measurement of statutory receivables should be:
  - (a) located in the revenue standards(s); or
  - (b) located in a separate standard?
11. Which of these possible proposals does the IPSASB consider should be included in the revenue and expense project Consultation Paper?

## Next Steps

82. If the IPSASB wants a section on statutory receivables in the Consultation Paper, we will draft the relevant section, taking into account feedback from this meeting.

## Appendix A: Impairment requirements in IPSAS 26 and IPSAS 29

### Extract from IPSAS 26 Impairment of Cash-Generating Assets

22. An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.
- ...
25. In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:
- External sources of information
- (a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;
  - (b) Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic, or legal environment in which the entity operates, or in the market to which an asset is dedicated;
  - (c) Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;
- Internal sources of information
- (d) Evidence is available of obsolescence or physical damage of an asset;
  - (e) Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;
  - (f) A decision to halt the construction of the asset before it is complete or in a usable condition; and
  - (g) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.
- ...
26. The list in paragraph 25 is not exhaustive. An entity may identify other indications that an asset may be impaired, and these would also require the entity to determine the asset's recoverable amount.
27. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:
- (a) Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
  - (b) Actual net cash flows or surplus or deficit flowing from the asset that are significantly worse than those budgeted;

- (c) A significant decline in budgeted net cash flows or surplus, or a significant increase in budgeted loss, flowing from the asset; or
- (d) Deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

...

36. In some cases, estimates, averages and computational shortcuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value in use.

#### **Extract from IPSAS 29 Financial Instruments: Recognition and Measurement**

48. ....All financial assets except those measured at fair value through surplus or deficit are subject to review for impairment in accordance with paragraphs 67–79 and Appendix A paragraphs AG117–AG126.

...

65. or financial assets and financial liabilities carried at amortized cost (see paragraphs 48 and 49), a gain or loss is recognized in surplus or deficit when the financial asset or financial liability is derecognized or impaired, and through the amortization process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 87–94 and Appendix A paragraphs AG131–AG141) the accounting for the gain or loss shall follow paragraphs 99–113.

#### **Impairment and Uncollectibility of Financial Assets**

67. **An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 72 (for financial assets carried at amortized cost), paragraph 75 (for financial assets carried at cost) or paragraph 76 (for available-for-sale financial assets) to determine the amount of any impairment loss.**
68. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognized. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:
- (a) Significant financial difficulty of the issuer or obligor;
  - (b) A breach of contract, such as a default or delinquency in interest or principal payments;
  - (c) The lender, for economic or legal reasons relating to the borrower’s financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
  - (d) It becoming probable that the borrower will enter bankruptcy or other financial reorganization;

- (e) The disappearance of an active market for that financial asset because of financial difficulties; or
- (f) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - (i) Adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments); or
  - (ii) National or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

...

*Financial Assets Carried at Amortized Cost*

72. **If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in surplus or deficit.**
73. An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 68). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.
74. **If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in surplus or deficit.**

## **ISSUES PAPER, *NON-EXCHANGE EXPENSES—MODIFICATIONS TO EXISTING GUIDANCE AS ALTERNATIVES***

### **Introduction and Background**

1. Throughout the development of the non-exchange expenses segment of this project, much of the discussion has focused on two potential alternatives: (1) application of the guidance for provisions in International Public Sector Accounting Standard (IPSAS 19), *Provisions, Contingent Liabilities and Contingent Assets*; and (2) expansion of the scope of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to include guidance for expenses from non-exchange transactions.
2. Previous agenda papers have focused on the practical application of each of these approaches as well as the advantages and disadvantages. This paper explores the core principles underlying IPSAS 19 and IPSAS 23 and evaluates those principles against *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Conceptual Framework). The paper also describes the advantages and disadvantages of each approach from a conceptual standpoint. Selected definitions of financial statement elements and descriptions of related terms from the Conceptual Framework are included as Appendix A.
3. This paper also provides detailed discussion of the modifications that could be made to IPSAS 19 and IPSAS 23 to provide guidance for non-exchange expenses.

### **Conceptual Comparisons**

#### *IPSAS 19*

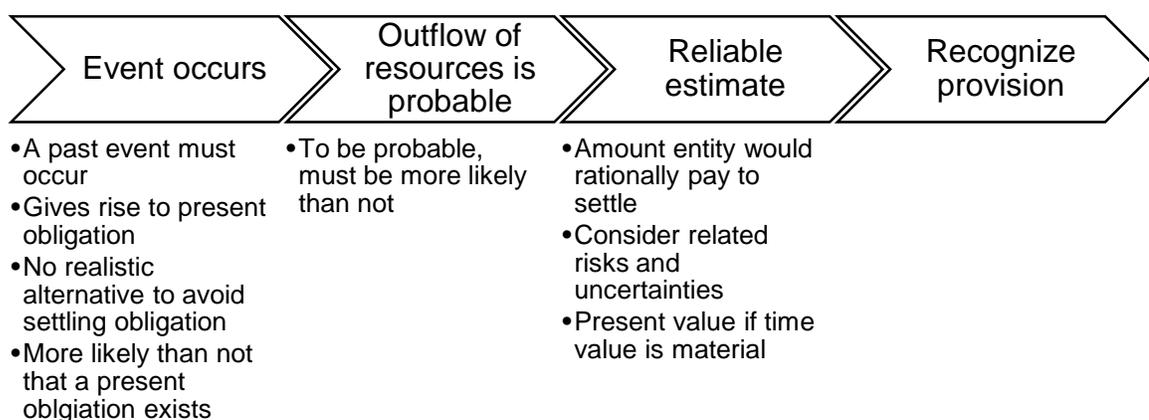
4. IPSAS 19 states that a provision should be recognized when (a) an entity has a present obligation as a result of a past event, (b) it is probable that an outflow of resources will be required to settle the obligation, and (c) a reliable estimate of the amount of the obligation can be made.
5. IPSAS 19 recognizes that it may not be clear whether there is a present obligation. Paragraph 23 of IPSAS 19 states that when it is not clear, “a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is *more likely than not* that a present obligation exists at the reporting date.” An obligating event is a past event that leads to a present obligation. Paragraph 25 states the following regarding an obligating event:

For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settle the obligation created by the event. This is the case only:

  - (a) Where the settlement of the obligation can be enforced by law; or
  - (b) In the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.
6. The Standard also notes that in order for a liability to qualify for recognition, the probability of the outflow of resources also must be present. Paragraph 31 states:

For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not.

7. IPSAS 19 distinguishes provisions from both other liabilities, such as payables and accruals, and contingent liabilities. Provisions differ from other liabilities due to uncertainty in the timing or amount of the expenditure required to settle the obligation. Although estimates may be necessary for certain accruals, the uncertainty is generally much less than that for provisions. Contingent liabilities are not recognized because they are either possible obligations or present obligations that do not meet the recognition criteria in IPSAS 19.
8. Provisions are measured at the amount the entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. The estimate should consider risks and uncertainties surrounding the events and circumstances of the present obligation. If the time value of money is material, the provisions should be the present value of the expenditures expected to be required to settle the obligation.
9. The following diagram illustrates the approach in IPSAS 19:



10. IPSAS 19 uses the notion of “more likely than not” to determine the point at which a provision is recognized. The Conceptual Framework defines liabilities in terms of present obligations, which are described as obligations that an entity has little or no realistic alternative to avoid.
11. Paragraph 31 of IPSAS 19 provides a discussion of the term “more likely than not.” The Conceptual Framework does not use any notion of probability in the definition of a liability, other than the liability definition includes the idea that an entity has “little or no realistic alternative to avoid” the outflow of resources. IPSAS 19 includes the notion of “no realistic alternative to avoid” in the definition of an obligating event. This difference between “more likely than not” and “little or no realistic alternative to avoid” is the primary difference between the guidance in IPSAS 19 and the Conceptual Framework.

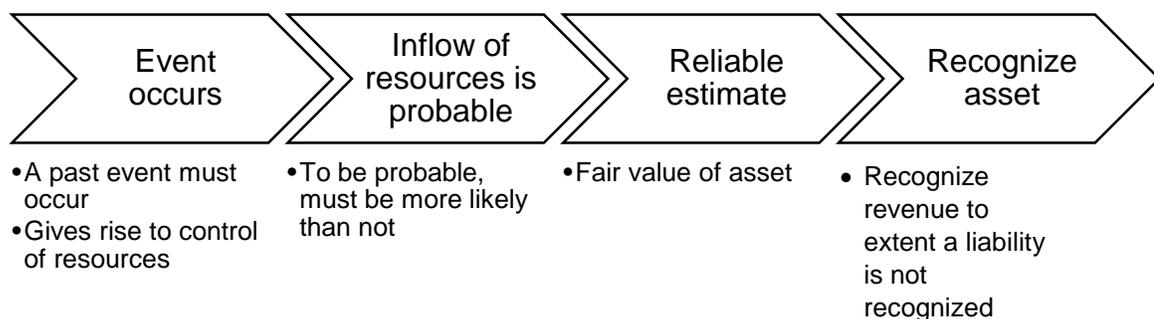
12. Some of the terminology in IPSAS 19 differs slightly from that used in the Conceptual Framework. For example, IPSAS 19 indicates that a present obligation may be legal or *constructive*. A constructive obligation is defined in paragraph 18 of IPSAS 19 as:
- ...an obligation that derives from an entity's actions where:
- (a) By an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
  - (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
13. In contrast, the Conceptual Framework describe present obligations as either legally binding or *non-legally-binding* obligations. Non-legally binding obligations are described in paragraphs 5.23-5.26 of the Conceptual Framework. Non-legally binding obligations that give rise to liabilities are described in paragraph 5.23 as having the following attributes:
- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
  - As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
  - The entity has little to no realistic alternative to avoid settling the obligation arising from those responsibilities.
14. The attributes of a non-legally binding obligation are consistent with those of a constructive obligation, however, the final attribute regarding no realistic alternative to avoid settling the obligation is not present in the IPSAS 19 description of a constructive obligation. This difference in terminology, however, is secondary to the difference in probability evaluation described above.

### IPSAS 23

15. The objective of IPSAS 23 is to provide requirements for reporting revenue from non-exchange transactions, other than those related to an entity combination. IPSAS 23 is a control-based standard that guides entities to recognize an asset from a non-exchange transaction when the entity gains control of resources that meet the definition of an asset and satisfies the recognition criteria.
16. IPSAS 23 indicates that an inflow of resources from a non-exchange transaction that meets the definition of an asset is recognized as an asset when and *only* when, (a) it is probable that the future economic benefits or service potential associated with the asset will flow to the entity and (b) the fair value of the asset can be measured reliably.
17. To recognize an asset, the control of resources must be as a result of a past event. Events that are expected to occur in the future do not give rise to assets in themselves—for example, the power or intention to levy a tax is not a past event.
18. To recognize an asset from a non-exchange transaction, an entity must determine that it is probable that the future economic benefits or service potential associated with the asset will flow to the entity. Paragraph 35 of IPSAS 23 describes a probable inflow of resources as one in which the “inflow is more likely than not to occur.” The paragraph indicates that an entity's past experience with similar

types of flows and of resources and its experience with a resource provider should provide the basis for the entity's determination of the probability of the inflow.

19. A present obligation from non-exchange transaction is recognized as a liability when and only when it is (a) probable that an outflow of resources embodying future economic benefits or service potential will be required to settle the obligation and (b) a reliable estimate can be made of the amount of the obligation. IPSAS 23 does not further describe the probability of the outflow of resources.
20. A present obligation is a duty to act or perform in a certain way. A present obligation may give rise to a liability and may be imposed by stipulations in laws, regulations, or binding arrangements. A present obligation also may arise from the normal operating environment. The performance against the condition has to be required and able to be assessed. IPSAS 23 distinguishes between conditions and restrictions. It states that conditions on transferred assets give rise to present obligations but that restrictions do not.
21. As an entity satisfies a present obligation recognized as a liability, the entity shall reduce the liability and recognize revenue. A present obligation may be satisfied when the taxable event occurs or the condition is satisfied.
22. The amount of liability recorded is the best estimate of the amount required to settle the present obligation at the reporting date. If the time value is material, the amount of the liability should be recognized at present value in accordance with the principles in IPSAS 19.
23. The following diagram demonstrates the overall summary of the approach described in IPSAS 23:



24. Assets are measured at fair value and liabilities are measured at the best estimate of the amount to settle the obligation, using present value methods if the time value is material.
25. Similar to IPSAS 19, IPSAS 23 uses the notion of “more likely than not” to determine the point at which an asset from a non-exchange transaction is recognized. The Conceptual Framework defines assets as resources controlled by an entity as a result of a past event, without reference to the likelihood of an inflow of those resources. Paragraph BC6.5 of the Conceptual Framework states that “guidance may be provided at a standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in a particular situation.”
26. The use of the “more likely than not” threshold to recognize an asset from a non-exchange transaction represents a tension with the Conceptual Framework definition of an asset by introducing the probability of an inflow as a requirement prior to the recognition of an asset. If expansion of the guidance in IPSAS 23 to expenses is pursued without modification, this could result in a similar dislocation of the resulting guidance for recognizing a liability with the definition of a liability in the

Conceptual Framework, similar to the dislocation in IPSAS 19. Because both alternatives have similar potential for tension with the Conceptual Framework, neither alternative is preferable from a conceptual view without modification. As part of the IPSASB's work on developing guidance for revenues and non-exchange expenses, the need to consider how the recognition criteria in the Conceptual Framework should be reflected at a standards-level will be explored.

## **Potential Modifications to IPSAS 19**

27. The current scope definition of IPSAS 19 is described in paragraphs 1-6 and specifically excludes certain transactions. Paragraph 1 states that the Standard should be applied in the accounting for provisions, contingent liabilities, and contingent assets except those arising from:

- Social benefits;
- Executory contracts, other than onerous contracts;
- Insurance contracts;
- Transactions covered by another IPSAS;
- Income taxes or equivalents; and
- Employee benefits, except employee termination benefits that arise as a result of a restructuring.

Paragraph 4 states that Standard does not apply to financial instruments. Non-exchange expenses are not specifically addressed in the scope of IPSAS 19.

28. As previously noted, the description of a provision is contrasted with liabilities, such as payables and accrued liabilities. Paragraph 19 of IPSAS 19 distinguishes provisions from other liabilities by the uncertainty about the timing or amount of the future expenditure required in settlement. The paragraph continues by describing payables as liabilities to pay for goods or services that have been received and invoiced or formally agreed with the supplier, while accruals are liabilities to pay for goods or services that have been received, but not formally invoiced or agreed with the supplier.
29. A typical non-exchange transaction of a resource provider may relate to a transfer from one public sector entity to another. These arrangements may not be invoiced; therefore, recording in payables or accruals may not be likely. Preparers and auditors also may not consider these transactions to be uncertain as to timing or amount; therefore, consideration as a provision may not be likely. To consider application of IPSAS 19 to these non-exchange transactions of resource providers, two primary modifications to IPSAS 19 may be considered.
30. One modification to IPSAS 19 is to revise the scope to specifically include non-exchange transactions of resource providers in the scope and include examples of non-exchange transactions in the Implementation Guidance. The second potential modification is to the "more likely than not" threshold specified in IPSAS 19 for recognition of a provision. These modifications, with related advantages and disadvantages, are described below.

### *Scope Revision and Implementation Guidance*

31. As described above, the current scope of IPSAS 19 specifies certain exclusions. The scope also describes specific transactions or groups of transactions to which the Standard should be applied. Therefore, the scope could be modified to specifically include application to non-exchange transactions of a resource provider.
32. To illustrate the application of the scope clarification, consider an example transaction. A central government provides a grant for CU500,000 to a not-for-profit entity to support the objectives of the not-for-profit entity. The central government does not specify a purpose for use of the funds by the not-for-profit entity and executes a grant agreement on 15 November. The agreement does not specify a payment date for the funds and no payment has been made by the central government at the end of the central government's reporting period on 31 December.
33. The IPSAS 19 approach, without any additional modifications, would require the central government to determine if the central government has a present obligation, either legal or constructive, as a result of the past event. The execution of the grant agreement could be considered a past event that gives rise to a legal or constructive obligation. The contractual laws in the related jurisdiction must be considered. Even if the likelihood that the recipient will use legal remedies to pursue enforcement of the agreement is remote, the possibility of enforcement is sufficient to constitute a legal obligation. Therefore, the central government has a present obligation as a result of a past event to settle with the not-for-profit entity.
34. The next criterion to satisfy for recognition of a provision is that it is probable, or more likely than not, that an outflow of resources will be required to settle the obligation. In the example described, an outflow of resources is more likely than not to occur. The final criterion is that a reliable estimate can be made of the amount of the obligation. The agreement specifies the amount of the transfer to be made; therefore, a reliable estimate can be made. This example transaction would be recognized as a provision.
35. This example could be included in the Implementation Guidance to IPSAS 19. The Implementation Guidance currently describes the examples, with discussion of the analysis and conclusion. Using that format, the example described here could be as follows:

IGX. A government agrees to provide a grant to a not-for-profit entity. The grant does not specify the manner in which the funds must be used by the not-for-profit. The agreement is executed on 15 November. At the end of the reporting period on 31 December, no payment has been made by the central government.

#### **Analysis**

Present obligation as a result of a past obligating event – The obligating event is the execution of the grant agreement between the government and the not-for-profit entity.

An outflow of resources embodying economic benefits or service potential in settlement – Probable.

#### **Conclusion**

A provision is recognized for the best estimate of the amount to be paid based on the terms of the grant agreement.

### Advantages

36. Revising the scope of IPSAS 19 to include non-exchange transactions of resource providers provides clear direction to preparers and auditors regarding the guidance to apply. Specifically including non-exchange transactions of resource providers in the scope of IPSAS 19 provides the opportunity to incorporate implementation guidance that does not currently exist for non-exchange expenses that are not social benefits.

### Disadvantages

37. Specifically identifying non-exchange transactions of a resource provider in the scope of IPSAS 19 has two primary disadvantages. First, IPSAS 19 was drawn primarily from IAS 37, which did not contemplate non-exchange transactions. While the Implementation Guidance of IPSAS 19 was amended to be more reflective of the public sector, there are no specific examples of non-exchange transactions. Some of the examples, such as warranties and refunds, describe exchange transactions. Other examples involve consideration of environmental liabilities, which also are significantly different from non-exchange transactions. Determination of the past event that gives rise to a present obligation can be more difficult for non-exchange transactions. The example described above is fairly simple; however, situations in practice may be much more complex.
38. Second, continuing to apply the IPSAS 19 model to non-exchange transactions may result in the recognition of transactions that are very similar to social benefit transactions at a different point in time. The social benefits project is currently in the process of evaluating feedback from stakeholders regarding the point in time at which an obligating event may exist. Preliminary results indicate that the obligating event may be defined at various points depending upon the program. Use of the guidance in IPSAS 19 may not be consistent with the results of the social benefits project. This could be considered at a later stage if necessary.

### *Probability Threshold*

39. The second modification to consider for IPSAS 19 is to the probability threshold. Currently, an outflow of resources must be “more likely than not” for a provision to be recorded. The threshold could be modified to be consistent with the Conceptual Framework to “the entity must have little to no realistic alternative to avoid the outflow.” Using the same example from above, the effects of this modification can be evaluated.
40. The use of the term “constructive” obligation also could be replaced with “non-legally” binding. This modification also would align the terminology with the Conceptual Framework.
41. The central government still must determine if the central government has a present obligation, either legally binding or non-legally binding, as a result of the past event. The execution of the grant agreement could be considered a past event that gives rise to a legally binding or non-legally binding obligation. The contractual laws in the related jurisdiction must be considered. Even if the likelihood that the recipient will use legal remedies to pursue enforcement of the agreement is remote, the existence of availability of enforcement is sufficient to constitute a legal obligation. Therefore, the central government has a present obligation as a result of a past event to settle with the not-for-profit entity.
42. The next criterion to satisfy for recognition of a provision is that the central government has little to no realistic alternative to avoid the outflow of resources. In the example described, the only alternative to avoid the outflow of resources is to breach the terms of the agreement. If the agreement is not

enforceable, then the central government may have an alternative to avoid the outflow. However, in this example, the agreement is assumed to be enforceable and there is no alternative to avoid the outflow. The final criterion is that a reliable estimate can be made of the amount of the obligation. The agreement specifies the amount of the transfer to be made; therefore, a reliable estimate can be made. This example transaction would be recognized as a provision.

43. This example could be included in the Implementation Guidance to IPSAS 19. The Implementation Guidance currently describes the examples, with discussion of the analysis and conclusion. Using that format, the example described here could be as follows:

IGX. A government agrees to provide a grant to a not-for-profit entity. The grant does not specify the manner in which the funds must be used by the not-for-profit. The agreement is executed on 15 November. At the end of the reporting period on 31 December, no payment has been made by the central government.

#### **Analysis**

Present obligation as a result of a past obligating event – The obligating event is the execution of the grant agreement between the government and the not-for-profit entity.

An outflow of resources embodying economic benefits or service potential in settlement – no alternative to avoid.

#### **Conclusion**

A provision is recognized for the best estimate of the amount to be paid based on the terms of the grant agreement.

#### **Advantages**

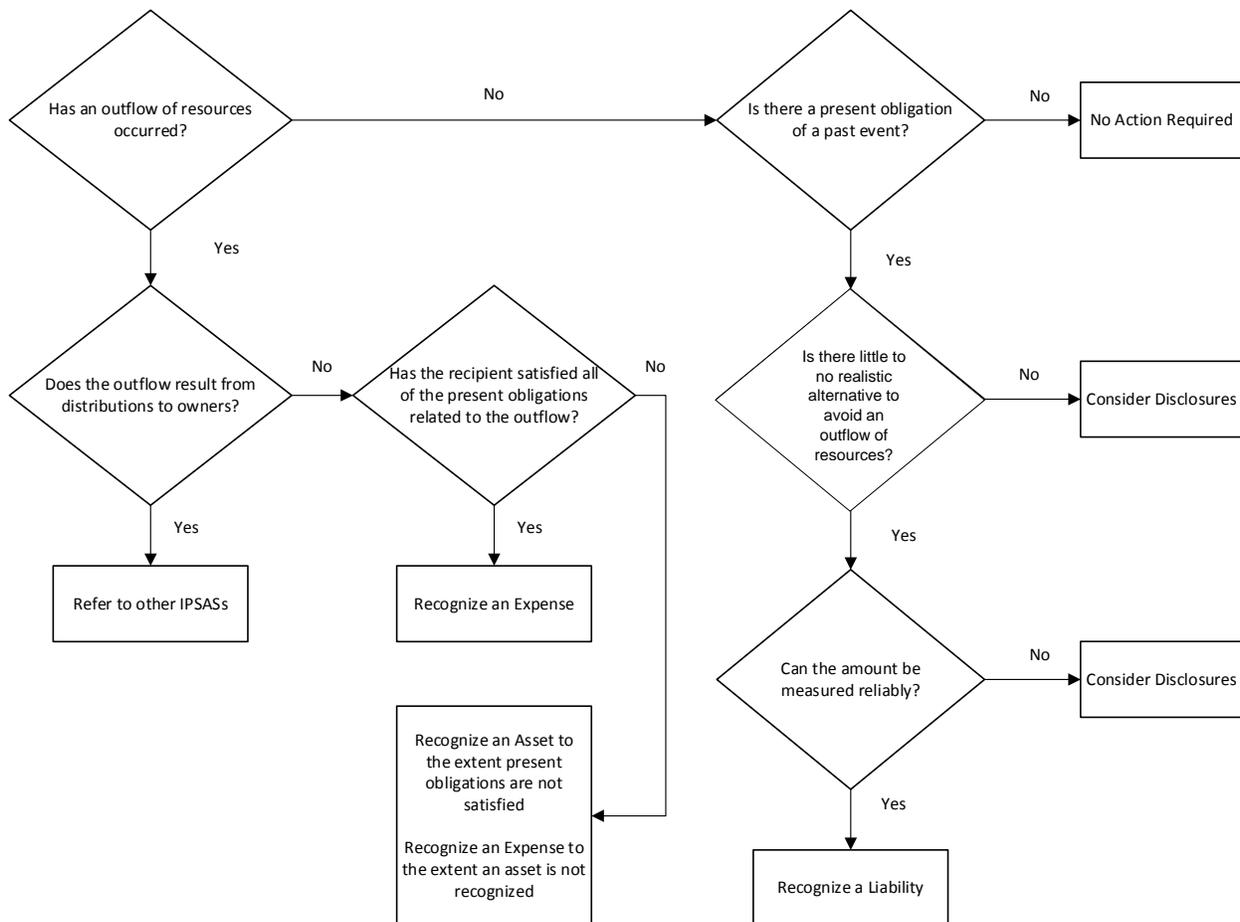
44. Modification of the threshold for recognition as a liability to be consistent with the Conceptual Framework provides a conceptually sound approach to the recognition of liabilities and expenses related to non-exchange transactions. Although the other alternatives considered in this project are also intended to be in accordance with the Conceptual Framework, the alternative to use an IPSAS 19 approach without modification to the recognition threshold is not as conceptually sound.
45. The recognition approach identified in the social benefits project as the obligating events approach results in recognition of a liability for social benefits when there is an obligating event that causes the entity to have little to no realistic alternative to avoid an outflow of resources. The modification to IPSAS 19 here is consistent with the approach described for social benefits, resulting in greater likelihood that non-exchange transactions that are not social benefits, yet are similar in nature to social benefits, will be treated in a similar manner as social benefits.

#### **Disadvantages**

46. The primary disadvantage to modifying the “more likely than not” threshold to recognize a provision related to non-exchange transactions is the potential effect on the current guidance in IPSAS 19. If the threshold is only modified for non-exchange transactions, not those that are already considered in IPSAS 19, use of two different thresholds in one Standard potentially would be confusing to preparer and auditors. The confusion of which threshold to apply could lead to diversity in practice. Of course, the scope could be expanded; however, that alternative presents another set of challenges.

## IPSAS 23

47. Previous agenda papers have described potential modifications to IPSAS 23 for application to non-exchange expenses. This paper continues that discussion, including additional revisions to illustrative flow charts to supplement the discussion.
48. One of the sticking points of the previous modifications was the attempt to apply the current steps to a situation in which an outflow of resources has already occurred, such as in the case of an advance payment of a grant or other arrangement when a present obligation exists for the resource recipient. The decision steps for the IPSAS 23 approach need to be modified to include an initial evaluation of whether or not an outflow has occurred. If the outflow has occurred, then the resource provider evaluates whether or not the outflow is a distribution to owners. If not, then the outflow is evaluated to determine if the recipient has a present obligation that has not yet been satisfied at the time of payment. If the obligation has not been satisfied by the recipient, then the recipient has a liability to record and the resource provider has an asset. To the extent that an asset is not recognized, the provider recognizes an expense for the outflow.
49. If an outflow has not occurred, the resource provider needs to evaluate whether or not there is a present obligation to be recognized. Current IPSAS 23 guidance for the recognition of assets requires recipients to evaluate whether or not the recipient controls resources as a result of a past event, the inflow of resources is probable (more likely than not), and the fair value of the asset can be measured reliably. Although IPSAS 23 requires entities to evaluate the probability of the inflow prior to recognition of an asset, the Conceptual Framework does not consider the probability of inflows for the recognition. To align IPSAS 23 with the Conceptual Framework, the consideration of probability could be removed. Rather than evaluate whether an outflow of resources is more likely than not, an entity would evaluate whether there was little to no realistic alternative to avoid the outflow. The criteria for the consideration of recognition of an outflow could be:
  - Is there a present obligation as a result of a past event?
  - Is there little to no realistic alternative to avoid an outflow of resources?
  - Can the amount of the obligation be measured reliably?
50. The following diagram reflects these decision points:



51. These modifications do not consider other modifications that may be proposed to IPSAS 23, including, but not limited to, the treatment of time requirements as conditions rather than restrictions and the requirements that a performance obligation and a return obligation must exist for a recipient to record a liability for the receipt of resources. Potential modifications to IPSAS 23 will be suggested at a future meeting, which may affect the modifications to the above in final guidance.

- Matter(s) for Consideration**
1. The IPSASB is **asked** to identify additional modifications to IPSAS 19 or IPSAS 23.
  2. The IPSASB is **asked** if it agrees with the advantages and disadvantages of the modifications described.
  3. The IPSASB is **asked** to identify additional advantages and disadvantages of the potential modifications.

## Appendix A: Conceptual Framework Definitions

The following definitions of elements of financial statements and description of related terms are provided in the Conceptual Framework:

<b>Element or term</b>	<b>Definition or description</b>
Asset	A resource presently controlled by the entity as a result of a past event. (paragraph 5.6)
Presently controlled	The ability of the entity to use the resource or direct other parties on its use so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives. (paragraph 5.11)
Past event (asset)	Past event may differ and may involve purchasing or developing assets or exercising sovereign power to obtain assets. An asset arises when the power is exercised and the rights exist to receive resources. (paragraph 5.13)
Liability	A present obligation of the entity for an outflow of resources that results from a past event. (paragraph 5.14)
Present obligation	A legally binding obligation or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. (paragraph 5.15)
Past event (liability)	May be a number of events. Where arrangements have legal form and are binding, such as contracts, the past event may be straightforward to identify. In other cases, entities must assess when the entity has little or no realistic alternative to avoid the outflow, taking jurisdictional factors into account. (paragraph 5.17)

**REVENUE AND EXPENSE CONSULTATION PAPER DRAFT****Appendix A: Overview of Existing IPSASs**

A.1 This Appendix provides an overview of the primary IPSASs that provide guidance for revenue and expenses.

*IPSAS 9*

A.2 IPSAS 9 provides guidance for the recognition of revenue from exchange transactions and requires public sector entities to identify the existence of transactions that involve the rendering of services, sale of goods, or use of entity assets yielding interest, royalties and dividends or similar distributions. Recognition of revenue through exchange transactions is based on a risks and rewards model, but the Standard does refer to the transfer of control over goods. Revenue from the sale of goods in an exchange transaction is recognized when the risks and rewards of the goods are transferred. Revenue from providing services in an exchange transaction is recognized based on the percentage of completion of the services.

A.3 IPSAS 9 was drawn primarily from IAS 18. The comparison between IPSAS 9 and IAS 18 notes the main differences between the two standards. It states:

- The title of IPSAS 9 differs from that of IAS 18, and this difference clarifies that IPSAS 9 does not deal with revenue from non-exchange transactions.
- The definition of “revenue” adopted in IPSAS 9 is similar to the definition adopted in IAS 18. The main difference is that the definition in IAS 18 refers to ordinary activities.
- Commentary additional to that in IAS 18 has also been included in IPSAS 9 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 9 uses different terminology, in certain instances, from IAS 18. The most significant example is the use of the term “net assets/equity” in IPSAS 9. The equivalent term in IAS 18 is “equity.”

*IPSAS 11*

A.4 IPSAS 11 provides guidance for the recognition of revenue from construction contracts. IPSAS 11 uses the existence of a construction contract as the starting point for determining revenue recognition and again uses a risks and rewards model. If the outcome of a contract can be reliably measured, revenue is recognized based on the percentage of completion of the construction. If the outcome is uncertain, revenue is recognized to the extent that costs are recoverable.

A.5 IPSAS 11 was drawn primarily from IAS 11. The comparison between IPSAS 11 and IAS 11 notes the main differences between the two standards. It states:

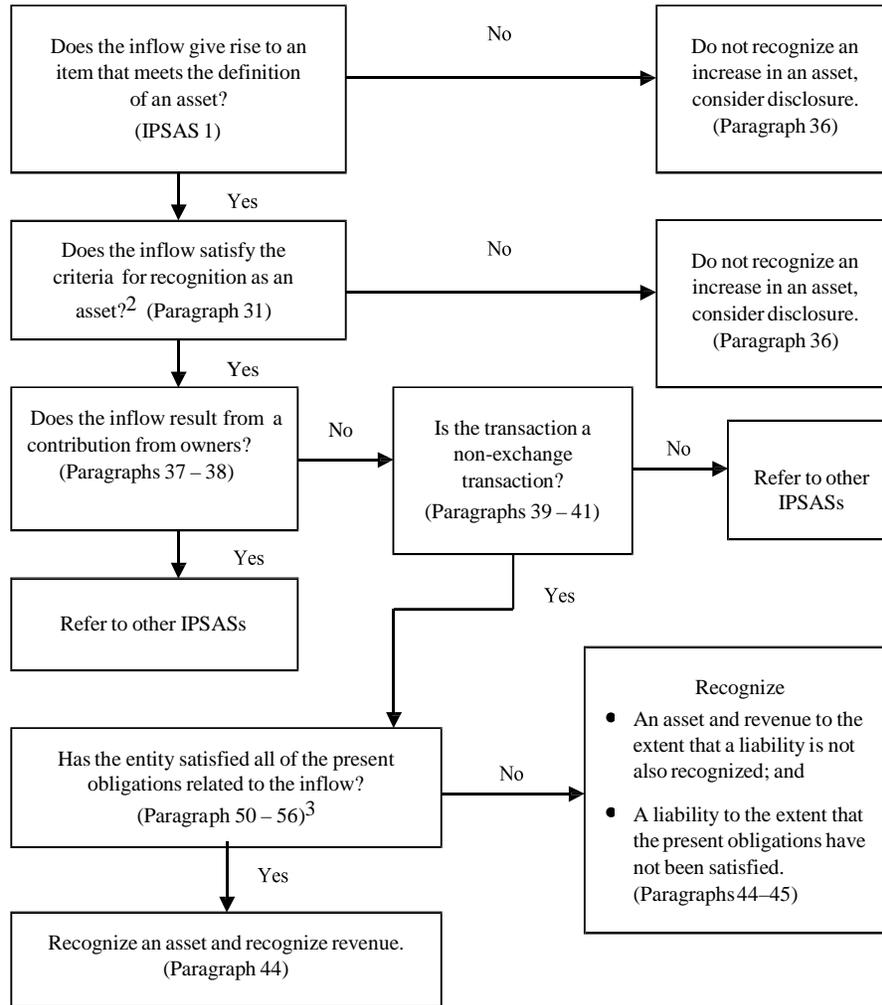
- Commentary additional to that in IAS 11 has been included in IPSAS 11 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 11 uses different terminology, in certain instances, from IAS 11. The most significant examples are the use of the terms “revenue,” and “statement of financial performance” in IPSAS 11. The equivalent terms in IAS 11 are “income,” and “income statement.”
- IPSAS 11 includes binding arrangements that do not take the form of a legal contract within the scope of the Standard.

- IPSAS 11 includes cost-based and noncommercial contracts within the scope of the Standard.
- IPSAS 11 makes it clear that the requirement to recognize an expected deficit on a contract immediately it becomes probable that contract costs will exceed total contract revenues applies only to contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to that contract.
- IPSAS 11 includes additional examples to illustrate the application of the Standard to noncommercial construction contracts.

### *IPSAS 23*

- A.6 IPSAS 23 resulted from a project that began in 2002. The IPSAS (then the Public Sector Committee) initiated a project to develop guidance for the recognition and measurement of revenue from non-exchange transactions. An Invitation to Comment (ITC) was published in January 2004 and Exposure Draft (ED) 29 was published in January 2006. In November 2006, the IPSASB approved IPSAS 23 for issuance. During development of the Standard, the IPSASB considered views expressed in the comment letters as well as views of the Steering Committee to develop a broad, principles-based approach to guidance for revenue from non-exchange transactions.
- A.7 IPSAS 23 provides guidance for the recognition of revenue from non-exchange transactions, including taxes and transfers. IPSAS 23 requires entities to use the existence of a right to an asset which may give rise to revenue as the starting point to evaluate the transaction. IPSAS 23 relies on the transfer of control of the asset rather than a risks and rewards model. If the entity controls the asset as a result of a non-exchange transaction, the entity recognizes an asset. The entity then determines if the resulting inflow from such assets is a contribution from owners. If the inflow is not a contribution, the entity then evaluates the existence of any present obligations related to the inflow. If a present obligation exists and meets the definition of a liability, a liability is recognized. Revenue is recognized to the extent that an asset is recognized and any present obligation is satisfied. IPSAS 23 includes a non-authoritative flow chart to assist in the evaluation of inflows of resources, as shown in Figure 1.

**Figure 1 – IPSAS 23 Illustration of the Analysis of Initial Inflows of Resources**



1. The flowchart is illustrative only, it does not take the place of this Standard. It is provided as an aid to interpreting this Standard.
2. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability.
3. In determining whether the entity has satisfied all of the present obligations, the application of the definition of conditions on a transferred asset, and the criteria for recognizing a liability, are considered.

**IPSAS 19 and Guidance for Specific Expenses**

A.8 While IPSAS 19 was not developed with non-exchange transactions in mind, it has been used as a source of guidance in IPSASs for accounting for provisions related to non-exchange expenses that are not social benefits. IPSAS 19 defines contingent assets, provisions, and contingent liabilities, and identifies how these transactions and other events should be recognized and measured. It also provides disclosure requirements related to those transactions. The Standard distinguishes between provisions, which are recognized as liabilities, and contingent liabilities, which are not recognized. IPSAS 19 explains that all provisions are distinct from other liabilities such as payables and accruals because the timing or amount of future expenditure required to settle a provision is uncertain.

- A.9 A provision is recognized when (1) an entity has a present obligation (legal or constructive) as a result of a past event; (2) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (3) a reliable estimate can be made of the amount of the obligation. In considering what is a present obligation, paragraph 51 of IPSAS 23 adds that a present obligation is a “duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts.”
- A.10 IPSAS 19 acknowledges that, in some circumstances, it may be unclear whether a present obligation exists. In those cases, a past event (obligating event) is considered to give rise to a present obligation if it is more likely than not that a present obligation exists at the reporting date. If the more likely than not threshold is not met, the entity discloses a contingent liability unless the possibility of a resource outflow is remote.
- A.11 For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only where the settlement of the obligation (a) can be enforced by law, or (b) the event creates valid expectations in other parties that the entity will discharge the obligation (as is the case for a constructive obligation).
- A.12 The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the reporting date. This is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. In circumstances where the effect of the time value of money is material, the amount of the provision that is recognized should be the present value of the expenditures expected to be required to settle the obligation. IPSAS 19 allows entities to consider the impact of future events—such as the effect of possible new legislation, inflation, or technological developments—on the amount of the liability that is recognized.
- A.13 In addition to IPSAS 19, several IPSASs contain guidance relevant to the recognition and measurement of expenses. Transactions within the scope of the following are excluded from the scope of this CP:
- Borrowing costs in the scope of IPSAS 5, *Borrowing Costs*;
  - Leases in the scope of IPSAS 13, *Leases* (also see discussion of leases below);
  - Interest expense related to investment property in the scope of IPSAS 16, *Investment Property*;
  - Costs associated with employee benefits in the scope of IPSAS 25, *Employee Benefits*; and
  - Expenses related to intangible assets in the scope of IPSAS 31, *Intangible Assets*.

## **Appendix B: Preparer Interviews**

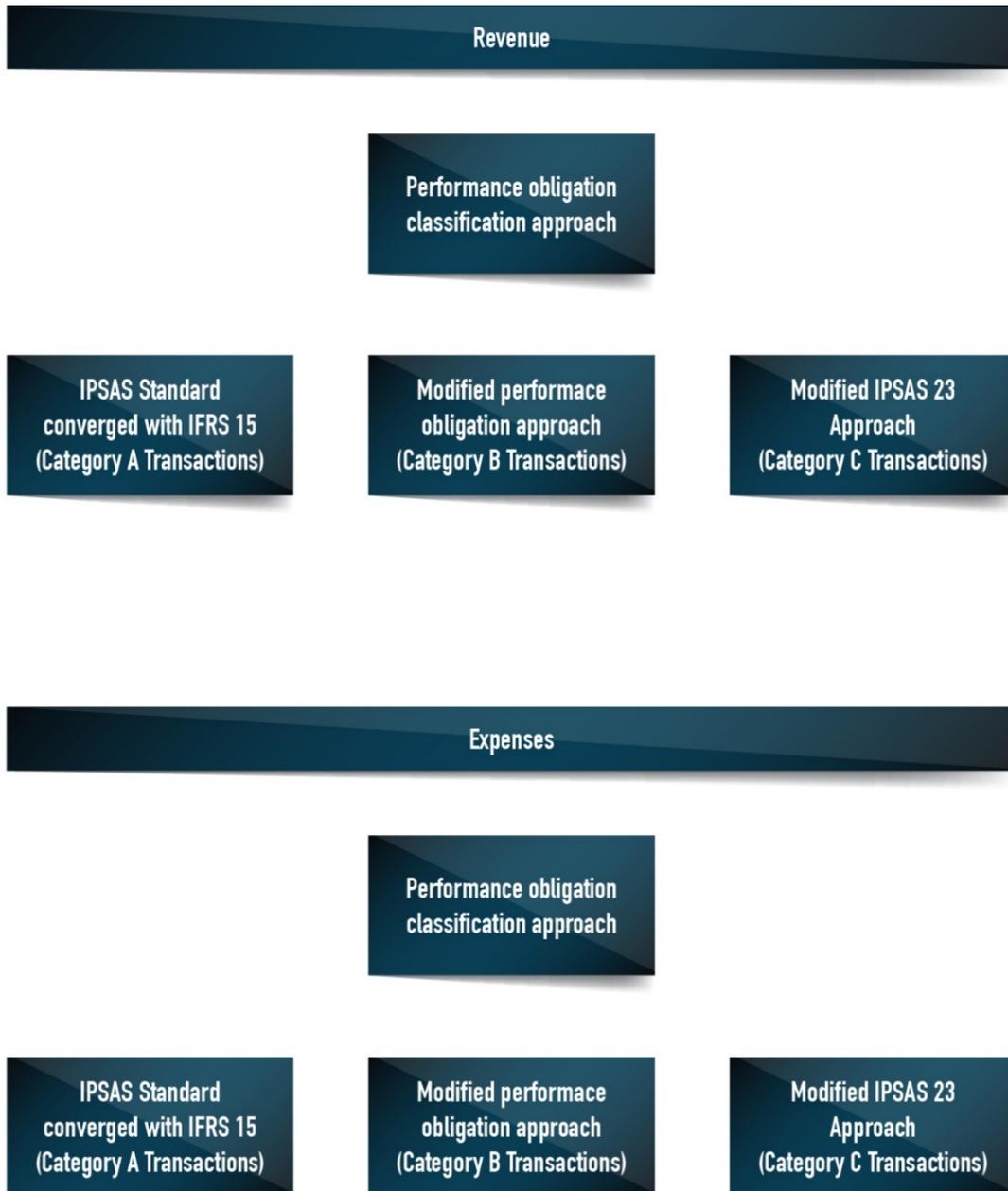
- B.1 The objectives of the outreach to preparers of public sector financial statements were to obtain feedback regarding how the standards have worked in practice and to identify any issues that the IPSASB may need to address in the revenue and non-exchange expenses projects.
- B.2 Preparers were asked to identify the types of non-exchange revenues and expenses that exist for the respondent's jurisdiction. Preparers were then asked to identify any difficulties encountered with recognition, measurement, or disclosure of those non-exchange revenues and expenses. Participants noted the following difficulties relevant to non-exchange revenues:
- determining whether stipulations are conditions or restrictions;
  - timing of recognition, especially for multi-year pledges received at the beginning of the arrangement;
  - recording pass-through transactions;
  - reporting in-kind services;
  - assessing probability of collection at initial recognition versus subsequent measurement;
  - reporting related to financing of construction projects; and
  - distinguishing between exchange and non-exchange transactions at an operational level.
- B.3 Some participants noted no issues or difficulties relevant to non-exchange expenses. Participants who identified difficulties relevant to non-exchange expenses noted the following issues:
- recording expenses over multiple years, including contributions and forbearance loans;
  - applying the "more likely than not" threshold from IPSAS 19 in practice;
  - defining an onerous contract;
  - measuring the expense;
  - accounting for concessionary, forbearance, and conditional loans; and
  - recording fiscal equalization payments based on statistical predictions.
- B.4 Preparers also were asked to share their views on the sufficiency of guidance in current IPSAS literature regarding the distinction between exchange and non-exchange revenues and expenses. Although that distinction was noted as a difficulty by some respondents, responses to this specific question varied. Some respondents indicated that the current IPSAS literature was sufficient, while other respondents stated that the IPSAS literature was insufficient. Some respondents who indicated the guidance was insufficient noted that, for certain transactions, such as fees and licenses, classifying the transaction as either a fee for service or a tax was challenging.
- B.5 The outreach related to non-exchange expenses also sought to understand certain aspects of the accounting for and reporting of non-exchange expenses that might not be as relevant to the discussion of non-exchange revenues. Given the lack of specific guidance in current IPSAS literature, the questions related to non-exchange expenses also asked respondents if they generally needed to record accruals for non-exchange expense transactions, as well as any guidance the entities may have consulted to determine the proper recording of non-exchange expense transactions.

- B.6 When asked if non-exchange expenses currently required the recording of accruals, respondents reported mixed answers. Some reported that accruals were made if the agreements had full legal force, but were not yet invoiced. Others reported that accruals were recorded if there was a commitment to pay. Still others reported that accruals were disclosed if the goods or services received could be verified as received and the amount was quantifiable. Some respondents indicated that accruals were not being made or were not significant.
- B.7 Respondents also reported a wide range of guidance that had been consulted when the respondents were considering the recording or reporting of these non-exchange expenses. Among the answers were IPSASB guidance, IASB guidance, consultation with auditors or accounting firms, and commercial law or accounting guidance of a standard setting group within their entity's jurisdiction.
- B.8 The outreach also sought to understand how prevalent the occurrence of stipulations, specifically time or purpose restrictions, were imposed on the non-exchange revenues or expenses of the entities. With regard to non-exchange revenues, many respondents indicated that they received resources with time or purpose restrictions. With regard to non-exchange expenses, many respondents with significant non-exchange expenses reported that the resources provided to recipients generally have either a time restriction, purpose restriction, or both.
- B.9 Interview participants generally noted challenges in accounting for and reporting non-exchange revenues that were received in advance for multiple years of funding. Some recipients also noted that accounting for stipulations caused challenges. While some respondents indicated that certain transactions, such as licenses and fees, were difficult to classify as exchange or non-exchange revenue, many respondents did not indicate concern with the conceptual distinction.
- B.10 Interview participants generally did not indicate significant issues with the accounting for or reporting of non-exchange expenses. Some participants did indicate that clearer guidance for non-exchange expenses than that provided in IPSAS 19 would be welcome. Many respondents with concessionary or forbearance loans also indicated that the accounting for such loans often was challenging.

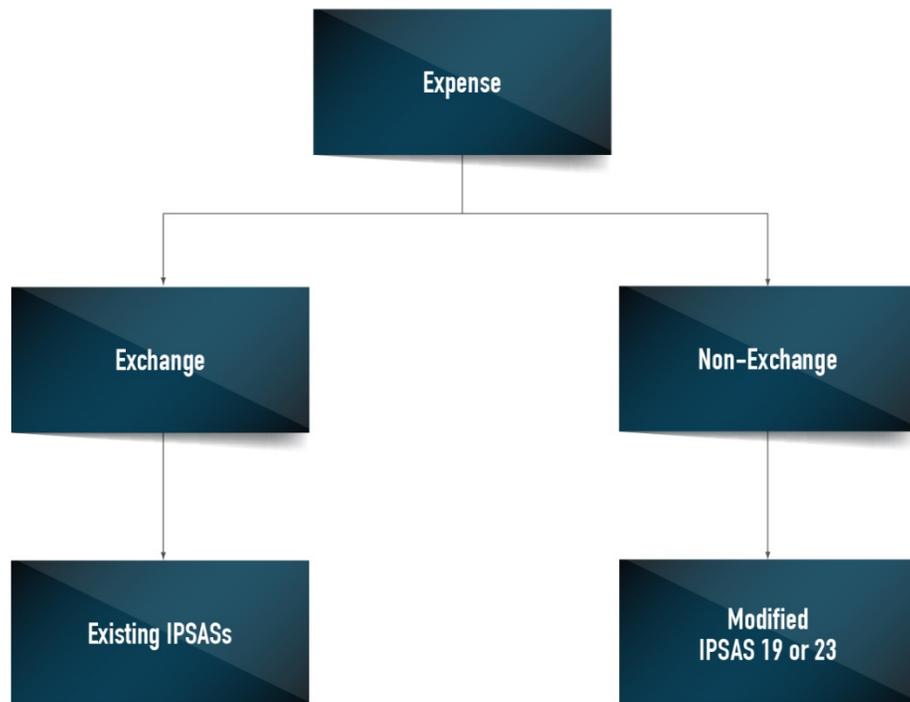
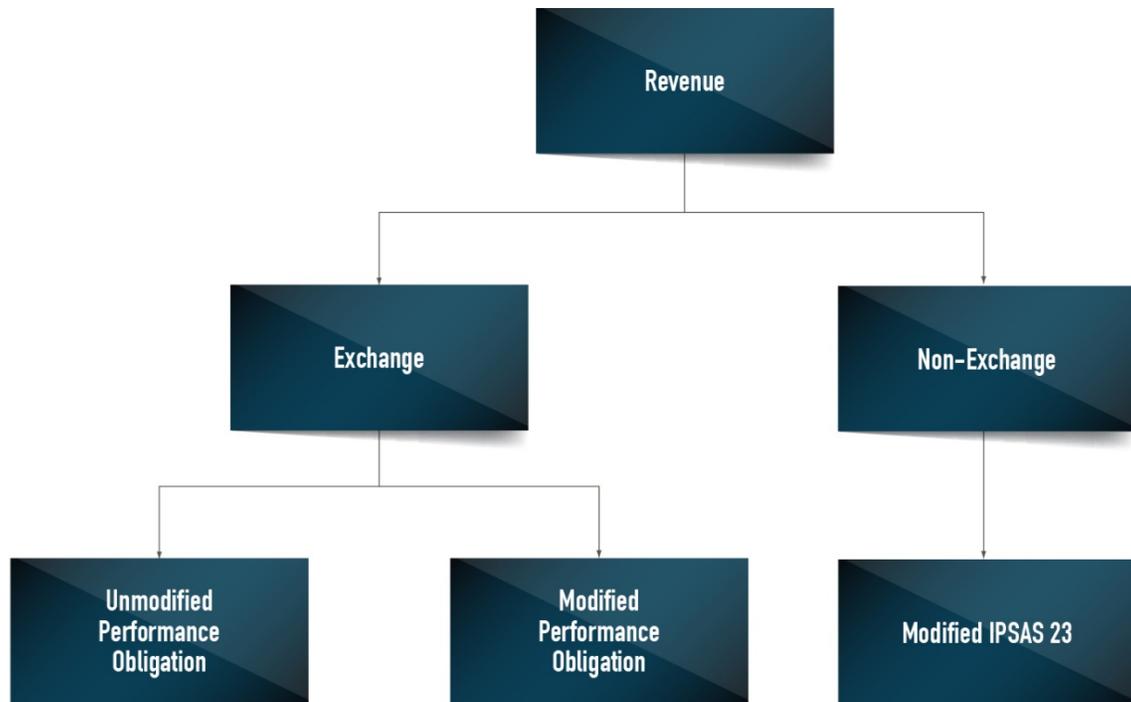
## Appendix C: Decision Trees

This Appendix provides a depiction of each overall approach considered in this CP to illustrate the alternatives described within each approach.

### Performance Obligation Approach



### Exchange/Non-Exchange Classification Approach



## Appendix D: Illustrative Examples

This Appendix present examples to illustrate the application of each of the recognition approaches described in this CP. The following examples are used:

*Master list of the examples with some sort of page referencing to allow readers to find specific examples if they choose.*

### Example 1: Vaccination Grant

	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 resource 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.

### Revenues

Add table for Performance Obligation Approach

Add table for Exchange/Non-Exchange Approach

### Expenses

Add table for Performance Obligation Approach

Non-Exchange Expense - IPSAS 19 and 23 Approaches		
Step	IPSAS 19	IPSAS 23
Has an outflow of resources occurred?	Not considered in this approach.	No.
Is there a present obligation as a result of an obligating event?	Yes, the provision of the vaccination by the local government health department.	Yes, the provision of the vaccination by the local government health department.

<p>Is there little to no realistic alternative for the resource provider to avoid the outflow of resources?</p>	<p>Yes, unless the local government health department must provide the minimum number of vaccinations to qualify for funding.</p>	<p>Yes, unless the local government health department must provide the minimum number of vaccinations to qualify for funding.</p>
<p>Can the amount of the obligation be estimated reliably?</p>	<p>Yes, the resource provider pays 50 percent of actual costs up to a maximum amount. The number of vaccinations and cost of each vaccination can be estimated reliably and used to calculate the amount of the obligation.</p>	<p>Yes, the resource provider pays 50 percent of actual costs up to a maximum amount. The number of vaccinations and cost of each vaccination can be estimated reliably and used to calculate the amount of the obligation.</p>
<p>Recognition – Resource Provider</p>	<p>DR Expense CR Provision for vaccination grant (liability) <i>Recognize expense and provision as vaccinations are performed</i></p> <p>DR Provision for vaccination grant CR Grant payable <i>Recognize payable and recognize decrease in provision at the point that payment is due – i.e. all 500 vaccinations have been performed (variation 1) or repeat this journal at the end of each month (variation 2).</i></p> <p>DR Grant payable CR Cash <i>Recognize decrease in grant payable and recognize decrease in cash when the central government pays for the vaccinations</i></p> <p>The only difference between variation 1 (single payment) and variation 2 (monthly payments) is the timing of the payment of cash.</p>	<p>DR Expense CR Provision for vaccination grant (liability) <i>Recognize expense and provision as vaccinations are performed</i></p> <p>DR Provision for vaccination grant CR Grant payable <i>Recognize payable and recognize decrease in provision at the point that payment is due – i.e. all 500 vaccinations have been performed (variation 1) or repeat this journal at the end of each month (variation 2).</i></p> <p>DR Grant payable CR Cash <i>Recognize decrease in grant payable and recognize decrease in cash when the central government pays for the vaccinations</i></p> <p>The only difference between variation 1 (single payment) and variation 2 (monthly payments) is the timing of the payment of cash.</p>