

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

**Meeting Location:** Stellenbosch, South Africa

**Meeting Date:** December 6–9, 2016

**From:** John Stanford

## Agenda Item 6

For:

☒ Approval

☒ Discussion

☒ Information

### REVENUE AND NON-EXCHANGE EXPENSES

|   |   |                       |
|---|---|-----------------------|
| <b>Project summaries</b>                  | <p><b>Revenue</b></p> <p>The aim of the project is to develop one or more IPSASs covering revenue transactions (exchange and non-exchange).</p> <p>The scope of this project is to develop new standards-level requirements and guidance on revenue to amend or supersede that currently in IPSAS 9, <i>Revenue from Exchange Transactions</i>; IPSAS 11, <i>Construction Contracts</i>; and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i>.</p> <p><b>Non-Exchange Expenses</b></p> <p>The aim of the project is to develop a standard(s) that provides recognition and measurement requirements applicable to resource providers in non-exchange transactions, except for social benefits.</p> |                       |
| <b>Meeting objectives</b>                 | <b>Topic</b>  | <b>Agenda Item</b>    |
| <b>Project management</b>                 | <a href="#">Instructions–September 2016 meeting and before</a>  | <a href="#">61.1</a>  |
|   | <a href="#">Decisions–September meeting and before</a>  | <a href="#">6.1.2</a> |
|   | <a href="#">Project roadmap</a>   | <a href="#">6.1.3</a> |
| <b>Decisions required at this meeting</b> | <a href="#">Modifications to Structure and Content of Consultation</a><br><a href="#">Paper Approval</a>  | 6.2.1                 |
| <b>Other supporting items</b>             | <a href="#">Draft Consultation Paper</a>  | 6.3.1                 |

# Agenda Item 6.1.1

## INSTRUCTIONS UP TO SEPTEMBER 2016 MEETING

| Meeting        | Instruction  | Actioned  |
|----------------|--|---|
| September 2016 | <p>Members were broadly supportive of the options presented in Chapter 5 (Measurement), although they instructed that the analysis should be broadened in places and the problem better articulated:</p> <ul style="list-style-type: none"> <li>• The items and transactions discussed are not financial instruments and therefore cannot be directly addressed in IPSAS 28-30, <i>Financial Instruments</i>;</li> <li>• The chapter should be clearer in its discussion of measurement at initial recognition;</li> <li>• The discussion of discounting should reflect high inflation environments; and the identification of market values;</li> <li>• For Approach 2–Amortized Cost Approach, the complexity of identifying a market rate was at origination, rather than on an ongoing basis; and</li> <li>• Because the chapter is based on a South African Accounting Standards Board (SAASB) Discussion Paper it would be helpful to provide the outcome of the SAASB's consultations and deliberations.</li> </ul> | Agenda Item 6.3.1<br>Material Revised and Expanded in Chapter 6                       |
| September 2016 | Members considered that the relationship of a modified IPSAS 19 to IAS 37 and the Conceptual Frameworks of the IPSASB and the IASB was unclear and instructed that it should be redrafted.   | Agenda Item 6.3.1<br>Material revised and references to Conceptual Frameworks deleted |
| September 2016 | The IPSASB instructed staff to revise the drafting of Chapter 4 (Non-Exchange Expenses: Initial Recognition) to reflect the IPSASB's discussions.  | Agenda Item 6.3.1<br>Chapter revised (now Chapter 5)                                  |
| September 2016 | The IPSASB instructed staff to revise the drafting of Chapter 3 (Recognition Options for Public Sector Specific Revenue Transactions) to reflect the IPSASB's discussions.   | Agenda Item 6.3.1<br><br>Chapter revised (now Chapter 4)                              |
| September 2016 | Regarding performance obligations and enforceability, the IPSASB instructed that staff should reflect the public sector context, so that enforceability could be reflected by mechanisms such as cabinet and ministerial decisions, appropriations and deductions from future funding for the same program. There should also be an emphasis on the ability to enforce, rather than a focus on the past record of enforcement.   | Agenda Item 6.3.1<br><br>Section on enforceability in Chapter 4 modified              |

| Meeting        | Instruction  | Actioned   |
|----------------|--|--|
| September 2016 | The IPSASB instructed staff to revise the drafting of Chapter 2 (Revenue Recognition Standards) to reflect the IPSASB's discussions.   | Agenda Item 6.3.1<br>Chapter 2 modified to include a small amount of additional material on IPSAS 11 |
| September 2016 | The IPSASB instructed staff to revise the drafting of Chapter 1 to address their concerns: <ul style="list-style-type: none"> <li>• Inappropriately balanced towards revenue rather than non-exchange expenses;</li> <li>• Emphasize that non-exchange expenses comprise very significant amounts for most public sector entities; and</li> <li>• The chapter insufficiently brought out the difficulties of interpretation of the exchange versus non-exchange demarcation.</li> </ul>  | Agenda Item 6.3.1<br>Revised material in Chapter 1   |
| September 2016 | In the context of revenue, the IPSASB instructed that there should be a better articulation of the issues, in particular the concerns that the provisions of IPSAS 23 on time requirements are too inflexible  | Agenda Item 6.3.1<br>Revised material in Chapter 1   |
| September 2016 | The IPSASB instructed staff to develop a new chapter dealing with the categorization of transactions, using material from Chapter 2 and Chapter 3.   | Agenda Item 6.3.1<br>New Chapter 3   |
| June 2016      | The IPSASB instructed staff to base the revised CP for review at the next meeting on the new structure agreed at the June 2016 meeting.  |  |
| June 2016      | The IPSASB instructed that the revenue section of the CP should focus on whether extending the performance obligation approach in IFRS 15 could solve some of the issues in IPSAS 23.  |  |
| June 2016      | The IPSASB instructed staff that the term "symmetry" should not be used, and that an alternative term, such as "consistency of approach" should be used instead.   |  |
| June 2016      | The IPSASB instructed staff that the CP should articulate an awareness of the broader implications of the issues but that the focus should be on the following three areas identified by the IPSASB as those where a public interest deficit exists: <ul style="list-style-type: none"> <li>• Gap in current literature related to non-exchange expenses;</li> <li>• Practical issues related to IPSAS 23; and</li> <li>• Updating revenue guidance to converge with IFRS 15.</li> </ul> |  |
| March 2016     | The IPSASB instructed staff that the description of categories for revenue recognition should not use the terms exchange or non-exchange in the performance obligation section of the CP.  |  |
| March 2016     | The IPSASB requested staff to explore the use of an alternative term or terms instead of "customer".   |  |

| Meeting        | Instruction  | Actioned |
|----------------|--|----------|
| March 2016     | The IPSASB instructed staff to develop examples of transactions between public sector and private sector entities.   |          |
| December 2015  | The IPSASB agreed that the performance obligation approach needs to take a broad view of binding arrangements and their enforceability in the public sector, noting that specific legislative requirements can give rise to performance obligations and that enforceability is not just through legal means. |          |
| September 2015 | The IPSASB agreed that the performance obligation approach and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Transfers and Taxes)</i> , approach should be applied to examples of transactions, so that each approach could be compared and contrasted.   |          |
| September 2015 | A performance obligation approach should be explored, using the definition in IFRS 15, <i>Revenue from Contracts with Customers</i> , as the starting point with appropriate modifications for the public sector   |          |
| September 2015 | The IPSASB directed that the issue of recognition of particular transactions should be discussed with the Social Benefits project staff.   |          |
| June 2015      | The IPSASB instructed staff to consider whether, for those revenue transactions where the other side of the transaction is a non-exchange expense within the scope of the non-exchange expenses project, there should be symmetrical accounting.   |          |
| June 2015      | The IPSASB instructed the revenue project staff to work closely with the non-exchange expenses project staff, where the projects intersect.  |          |
| June 2015      | The IPSASB instructed staff to consider the issues that have been raised in respect of IPSAS 23 and look to address those issues for revenue transactions that do not have a performance obligation, rather than starting from scratch.  |          |

# Agenda Item

## 6.1.2

### DECISIONS UP TO SEPTEMBER 2016 MEETING

| Date of Decision | Decision   |
|------------------|--|
| September 2016   | The IPSASB decided that the discussion of public sector transactions should be in a separate chapter (new Chapter 3), rather than in a chapter summarizing existing IPSASB and IASB literature. This chapter should also incorporate paragraphs 3.7-3.17 of old Chapter 3 and provide a stronger rationale for the IPSASB's view that IPSAS 9 and IPSAS 11 should be replaced by a new IPSAS primarily drawn from IFRS 15. |
| June 2016        | The IPSASB agreed that the CP will ask constituents if they are aware of any other implementation issues with IPSAS 23.  |
| June 2016        | The IPSASB decided that tax expenditures is beyond the scope of the Non-Exchange Expenses project but will be noted as a potential project for inclusion in the next work plan consultation.   |
| June 2016        | The IPSASB decided to request comments from constituents on whether extending the performance obligation approach in IFRS 15 could solve some of the issues in IPSAS 23. There will be a reference to the need to update IPSAS 9 and IPSAS 11 to maintain convergence with IFRS 15.  |
| March 2016       | The IPSASB confirmed that Statutory Payables and Statutory Receivables would be considered respectively in the Non-exchange Expenses and Revenue projects.   |
| March 2016       | The IPSASB agreed IAS 20 was not a good basis for guidance on revenue recognition because it is not consistent with either the IPSASB's Conceptual Framework or the IASB's current Conceptual Framework.   |
| March 2016       | The IPSASB agreed to combine the revenue and non-exchange expenses TBGs into a single TBG. This would be reviewed after the CP stage.  |
| March 2016       | The IPSASB agreed with the use of the cost of fulfillment measurement basis for non-exchange expenses.   |
| December 2015    | The IPSASB agreed to develop a single Consultation Paper covering both revenue and non-exchange expenses. The paper would address both the exchange/non-exchange and the performance obligation/no performance obligation approaches.  |
| December 2015    | The IPSASB agreed that a consultation paper phase is required for both the revenue and non-exchange expenses projects.   |
| June 2015        | The performance obligation approach in IFRS 15 is appropriate for accounting for some public sector revenue transactions.  |
| March 2015       | The IPSASB approved the project briefs for the revenue and non-exchange expenses projects  |

## Agenda Item 6.1.3

### REVENUE AND NON-EXCHANGE EXPENSES PROJECTS ROADMAP

| Meeting        | Objective: IPSASB to consider:  |
|----------------|---|
| December 2016  | <ol style="list-style-type: none"> <li>1. Review of proposed CP</li> <li>2. Approval of CP</li> </ol>   |
| March 2017     | Consultation period   |
| June 2017      |   |
| September 2017 | <ol style="list-style-type: none"> <li>1. Review of Responses</li> <li>2. Initial discussion on issues raised</li> </ol>  |
| December 2017  | <ol style="list-style-type: none"> <li>1. Discussion of issues raised</li> <li>2. Review first (partial) draft of proposed Exposure Drafts (number to be agreed)</li> </ol> |
| March 2018     | <ol style="list-style-type: none"> <li>1. Review of draft EDs</li> </ol>  |
| June 2018      | <ol style="list-style-type: none"> <li>1. Review of draft EDs</li> <li>2. Approval of EDs</li> </ol>  |
| September 2018 | Consultation period   |
| December 2018  |   |
| March 2019     | <ol style="list-style-type: none"> <li>1. Review of Responses</li> <li>2. Initial discussion on issues raised</li> </ol>  |
| June 2019      | <ol style="list-style-type: none"> <li>1. Discussion of issues raised</li> <li>2. Review first (partial) draft of proposed IPSASs</li> </ol>                                |
| September 2019 | <ol style="list-style-type: none"> <li>1. Review of draft IPSASs</li> </ol>   |
| December 2019  | <ol style="list-style-type: none"> <li>1. Review of draft IPSASs</li> <li>2. Approval of IPSASs</li> </ol>  |

**Modifications to Structure and Content of Consultation Paper****Questions**

1. The IPSASB is asked to note modifications to the structure of the Consultation Paper (CP), confirm that these are in accordance with instructions at the September 2016 meeting and approve the CP.

**Detail**

2. At the September 2016 meeting the IPSASB provided instructions for the revision of the structure and format of the paper. The main changes were that:
  - The material on the categorization of public sector transactions previously in the same chapter as the summary of literature on revenue should be relocated to a separate chapter.
  - The IFRS 15 five-step approach should be adopted for both Category B revenue and non-exchange expense transactions in discussion of a modified IFRS 15 approach. In the version of the paper at the September meeting a larger number of public sector characteristics had been identified and these had been cross-referenced to the five-step approach.
  - Enforceability was to be retained as an essential attribute of a modified performance obligation approach, but the discussion was to reflect public sector mechanisms and place less emphasis on a prior record of enforcement.
3. Because of the scale of the changes the draft CP at Agenda Item 6.3 is presented in clean version rather than mark-up. The main changes from the version on the agenda at the September 2016 meeting are:

*Chapter 1 Introduction*

- Material on the problems with the Exchange/Non-Exchange distinction has been relocated from the chapter on non-exchange expenses (Chapter 4 in the September version).
- Some explanatory material has been added on IPSAS 23 Implementation Issues (Time Requirements, Capital Grants and Services In-Kind)

*Chapter 2: Current Revenue Recognition Standards*

- In paragraph 2.16 some additional material has been added on the definitions in IPSAS 11, *Construction Contracts*,
- The material on the categorization of public sector transactions has been relocated to a new Chapter 3 (see below).

*Chapter 3: Analyzing Public Sector Transactions with Reference to the IFRS 15 Performance Obligation Approach*

- The material in Chapter 2 of the September 2016 version on the categorization of public sector transactions has been relocated to this new chapter.

- Material has been added to indicate that the categorization simplifies the real world. In practice, there is likely to be a spectrum of transactions—at one end transactions with no performance obligations, at the other end transactions with identifiable and enforceable performance obligations, with many transactions lying somewhere in between. Nevertheless the categorization is useful in allowing approaches to be assessed.
- Some of the material previously in paragraphs 3.7-3.17 of the chapter on Recognition Options for Public Sector Specific Revenue Transactions in the September version has been relocated to this chapter.
- The chapter includes Preliminary Views (PVs) on the approach to Category A transactions (those without performance obligations) and Category C transactions (those that meet IFRS 15 definitions). The Specific Matters for Comment on the same issues have been deleted as they duplicate the PVs.

#### *Chapter 4: The Public Sector Performance Obligation Approach, the Exchange/Non-Exchange Approach and Potential Revisions to IPSAS 23*

- The eight public sector performance obligation approach characteristics in the September version have been reconfigured into Five Steps drawn from IFRS 15 with the steps re-expressed for the public sector.
- A table has been added summarizing the approach to the three categories of public sector transactions outlined in Chapter 3 under the Public Sector Performance Obligation Approach.
- More explanatory material has been added on capital grants and a sub-section inserted on services-in-kind, asking whether the existing requirements in IPSAS 23, which permit, but do not require services in-kind to be recognized, should be modified.
- The section on Advance Receipts has been deleted as this largely duplicates issues on time requirements.
- For time requirements and capital grants sub-sections have been added on whether adoption of a performance obligation approach would resolve or partially resolve the identified implementation issue?

#### *Chapter 5: Non-Exchange Expenses—Initial Recognition*

- As indicated above material on problems with operationalizing the exchange/non-exchange distinction has been relocated to Chapter 1
- Explanatory material has been added on Other Transfers in Kind
- The seven public sector characteristics for the Public Sector Performance Obligation Approach have been reconfigured into the IFRS 15 Five Steps, slightly modified to reflect the non-exchange expenses context.

#### *Chapter 6 Measurement*

- The terms “non-contractual receivables” and “non-contractual payables” have been adopted, acknowledging that the scope extends beyond “statutory receivables” and “statutory payables” to donations and bequests.



- The three approaches for non-contractual receivables have been retained, but the material has been slightly expanded and edited.
- The three approaches for non-contractual payables have been retained, but the material has been slightly expanded and edited.
- The section has been slightly amended to indicate that it deals with measurement at initial recognition as well as subsequent measurement
- Footnotes have been added indicating the outcome of the South African Accounting Standards Board's consultation process on non-contractual arrangements that have the characteristics of financial instruments.

There are currently four preliminary views in Chapters 3 and 5. In a number of sections of the draft CP staff has asked the IPSASB whether it wants to express further preliminary views. Staff propose that these are discussed during the section-by-section review.

A preliminary draft Executive Summary has been included. This will have to be modified in light of discussion at the meeting.

Some fact patterns are being developed. These will be tabled at the meeting.

#### **Decision required**

Having reviewed the revised structure and format of the CP the IPSASB is asked to approve the CP.

**Consultation Paper**  
**January 2017**  
***Comments due: July 31, 2017***

# Accounting for Revenue and Non-Exchange Expenses

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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## Executive Summary

The IPSASB initiated the projects for which this CP is an intermediate output for a number of reasons:

- The problems of preparers in determining whether transactions are exchange or non-exchange distinction and the value of that distinction;
- The gap in the current IPSASB literature on non-exchange expenses leading to ambiguity and inconsistency of accounting policies in a highly significant area of expenditure;
- Implementation issues with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*; and
- Convergence with International Accounting Standards Board (IASB) literature, which has diminished with the publication of IFRS 15, *Revenue from Contracts with Customers* in 2014.

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 reflects the transfer of control of the asset to the customer. The amount of revenue recognized is equal to the consideration the entity is entitled to for satisfying the performance obligation. This performance obligation approach represents new thinking on the recognition of revenue in contractual arrangements. Because of IPSASB's commitment to maintain convergence with IFRS where appropriate the publication of IFRS 15 means that IPSASB needs to consider its impact.

This new thinking also gives a stimulus to IPSASB to re-evaluate requirements and guidance for revenue transactions and non-exchange expense transactions. In particular it raises the question of whether accounting approaches based on performance obligations are more straightforward than distinguishing exchange and non-exchange transactions and whether such approaches provide more useful information to users.

The IPSASB has categorized public sector transactions in order to explore this issue:

Category A: Revenue and non-exchange expense transactions with no performance obligations.

Category B: Revenue and non-exchange expense transactions with performance obligations that would not be in the scope of IFRS 15.

Category C: 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 in contractual arrangements.

The IPSASB expresses preliminary views that:

- IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts*, should be replaced with a new IPSAS primarily drawn from IFRS 15
- Regardless of whether a performance obligation approach is adopted for Category B revenue transactions IPSAS 23 or an IPSAS incorporating IPSAS 23 principles will need to be part of IPSASB's literature.

The CP outlines and evaluates two approaches for dealing with Category B revenue transactions:

- A Public Sector Performance Obligation Approach (PSPOA)
- The Exchange/Non-Exchange Approach

The PSPOA involves adoption of a modified form of the IFRS 15 Five-Step Approach, which reflects the public sector context. In particular, the approach is not restricted to contractual arrangements, but includes

binding arrangements and also acknowledges that funding arrangements in the public sector often involve the resource recipient delivering services to a resource beneficiary, rather than the resource provider.

Under the Exchange/Non-Exchange Approach the current distinction between exchange and non-exchange transactions is retained as the primary determinant of accounting treatments for both Category A and Category B transactions. IPSAS 23 would therefore continue to provide requirements and guidance for both Category B transactions as well as Category A transactions— that is revenue transactions classified as non-exchange, regardless of whether they contain performance obligations.

The IPSASB has identified time requirements, capital grants and services-in-kind as major implementation issues with IPSAS 23. The CP explores possible ways of modifying or clarifying requirements in these areas.

Non-exchange expenses include principally:

- (a) Collective goods and services;
- (b) Other transfers in kind; and
- (c) Transfers and grants to other entities.

The CP outlines and evaluates three approaches for dealing with non-exchange expense transactions:

- (a) The Expanded IPSAS 19 Approach;
- (b) The Public Sector Performance Obligation Approach; and
- (c) The IPSAS 23 Reverse Approach.

The Expanded IPSAS 19 approach would bring all non-exchange expenses that do not meet the definition of social benefits within the scope of a revised IPSAS 19 by not restricting liabilities to those of uncertain timing or amount.

Under the Expanded IPSAS 19 Approach the determinant of whether the transferor of resources has an expense and a liability is whether there is an obligating event – that is to say an event that creates a legal obligation or non-legally binding obligation that results in the transferring entity having no realistic alternative to settling that obligation.

The Public Sector Performance Obligation Approach the PSPOA for non-exchange expenses is the counterpart to that approach for revenue transactions discussed above. The five steps approach reconfigured from the perspective of the resource provider in order to determine when the resource provider has an expense and a liability as result of a resource recipient satisfying identifiable and specific performance obligations.

Under the IPSAS 23 Reverse Approach the transferor of resources determines whether a funding arrangement contains stipulations, and if so, whether those stipulations are conditions or restrictions. If an agreement contains only restrictions the provider will recognize an expense for the entire amount of the funding when the agreement becomes binding, because in the event of a breach of a restriction by the recipient the provider has no enforceable right to recover the resources. If an arrangement contains conditions the resource provider will continue to have an asset until the condition is satisfied by the recipient. This is because in the event of the recipient breaching the condition the provider will have an enforceable right to require the recipient to return the resources and therefore will control those resources until the condition is fulfilled.

The CP concludes by considering options for the initial and subsequent measurement of non-contractual receivables and non-contractual payables. The main issue is whether non-contractual receivables and payables should be accounted for in the same way as the financial instruments they resemble or whether their non-contractual nature justifies less complex approaches.

## REQUEST FOR COMMENTS

This Consultation Paper, *Public Sector Specific Financial Instruments*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by July 31, 2017.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the [“Submit a Comment”](#) link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this Consultation Paper, including all Preliminary Views and Specific Matters for Comment. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

The Preliminary Views and Specific Matters for Comment in this Consultation Paper are provided below. Paragraph numbers identify the location of the Preliminary View or Specific Matter for Comment in the text.

#### Preliminary View 1 (following paragraph 3.8)

The IPSASB considers that it is appropriate to replace IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* with an IPSAS primarily drawn from IFRS 15, *Revenue from Contracts with Customers*. Such an IPSAS will address Category C transactions that:

- (a) Involve the transfer of promised goods or services to customers as defined in IFRS 15; and
- (b) Arise from a contract (or equivalent binding arrangement) with a customer which establishes identifiable and enforceable performance obligations.

Do you agree with the IPSASB's Preliminary View 1? If not, please give your reasons

#### Preliminary View 2 (following paragraph 3.9)

Because Category A transactions do not contain performance obligations, IPSASB considers that these transactions will need to be addressed in either a revised IPSAS 23 or a standard incorporating IPSAS 23 principles.

Do you agree with the IPSASB's Preliminary View 2? If not, please give your reasons.

#### Specific Matter for Comment 1 (following paragraph 4.20)

The CP considers the Public Sector Performance Obligation Approach is only appropriate when agreed performance obligations in an arrangement are “identifiable and specific”.

The main criterion 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 that the performance obligation has been satisfied.

- (a) Do you agree with the use of the term identifiable and specific?
- (b) Do you agree with the criterion for determining when a performance obligation is identifiable and specific?

If you think that the criterion is too restrictive or that additional guidance should be provided please provide suggestions for any amendments.

**Specific Matter for Comment 2 (following paragraph 4.39)**

Do you agree that the cost of delivery approach is the appropriate method for allocating the total amount of funding (or other consideration) across identifiable and specific performance obligation?

If you think that there are alternative options please identify and explain them.

**Specific Matter for Comment 3 (following paragraph 4.45)**

Do you agree that the trigger for revenue recognition in the Public Sector Performance Obligation approach should be when the entity “satisfies the promised performance obligations”?

If you disagree please indicate what should be the trigger for revenue recognition and give your reasons?

**Specific Matter for Comment 4 (following paragraph 4.61)**

Where an entity transfers resources to a recipient with time requirements, but no conditions do you:

- (a) Favor the use of other resources and other obligations to indicate to users that the transferor intends that the recipient uses the resources in one or more future reporting periods; or
- (b) Consider that the use of other resources and other obligations is unnecessary and support the use of one or more presentational mechanisms to provide information to users on transactions with time requirements.

Please explain your reasons.

**Specific Matter for Comment 5 (following paragraph 4.64)**

- (a) Has the IPSASB identified the main issues with capital grants?
- (b) How do you think the IPSASB should modify requirements related to capital grants?

If you think that there are other issues with capital grants please identify them.

**Specific Matter for Comment 6 (following paragraph 4.68)**

Do you consider that the IPSASB should:

- (a) Modify the requirements of IPSAS 23 to require services in-kind that meet the asset definition and can be measured they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in general purpose financial reports;
- (b) Retain the existing requirements for services in-kind, which permits, but does not require recognition of services in-kind; or
- (c) Distinguish services that an entity would have purchased if they had not been donated and services that an entity would not have purchased if they had not been donated and require an entity only to recognize services that would have been purchased.

Please explain your reasons.

**Specific Matter for Comment 7 (following paragraph 4.76)**

Do you favor the Public Sector Performance Obligation Approach or the Exchange/Non-exchange approach for dealing with Category B revenue transactions?

If you support an alternative approach please describe this approach.

Please give your reasons



**Preliminary View 3 (following paragraph 5.13)**

The IPSASB is of the view that under the Expanded IPSAS 19 Approach collective goods and services do not give rise to obligating events and therefore expenses or liabilities do not arise prior to the delivery of those services to beneficiaries.

Do you agree with the IPSASB's Preliminary View 3? If not, please give your reasons.

**Preliminary View 4 (following paragraph 5.14)**

The IPSASB is of the view that under the Expanded IPSAS 19 Approach other transfers in kind do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of services to beneficiaries

Do you agree with the IPSASB's Preliminary View 4? If not, please give your reasons.

**Specific Matters for Comment 8 (following paragraph 5.46)**

Which, if any, of the three models discussed in this chapter do you support:

- (a) Expanded IPSAS 19 Model;
- (b) The Public Sector Performance Obligation approach; or
- (c) The IPSAS 23 Reverse Approach?

Please explain the reasons for your views. If you do not support any of the three approaches please provide details of the approach that you favor.

**Specific Matters for Comment 9 (following paragraph 6.18)**

Do you agree with option:

- (a) Best estimate of the discounted cash flows; or
- (b) Face value of the transaction(s) with the amount expected to be uncollectible recognized as an impairment—for the initial recognition of non-contractual receivables?

Please give your reasons.

**Specific Matter for Comment 10 (following paragraph 6.34)**

Which of the three approaches identified in this chapter for the subsequent measurement of non-contractual receivables do you support:

- (a) Fair Value or Market Value approach; or
- (b) Amortized Cost Approach; or
- (c) Cost Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

**Specific Matter for Comment 11 (following paragraph 6.43)**

Which of the three approaches identified in this chapter for the subsequent measurement of non-contractual payables to do you support:

- (a) Best Estimate for Settlement Approach; or
- (b) Amortized Cost Approach; or
- (c) Hybrid Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

# ACCOUNTING FOR REVENUE AND NON-EXCHANGE EXPENSES

## CONTENTS

|  | Page |
|--|------|
| To be inserted when CP finalized for publication |      |

## 1. Introduction

- 1.1 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. For decision-making and accountability purposes, users need information on the financial position, financial performance, and cash flows of an entity, as well as information on the:
- 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.
- 1.2 The sources of funding for public sector entities include taxation, transfers from other public sector entities, and fees and charges. Public sector entities use these resources to provide services to the public in diverse ways.
- 1.3 The IPSASB has developed a number of International Public Sector Accounting Standards (IPSASs) that address the particular characteristics of public sector entities and their transactions. Through its ongoing work program the IPSASB aims to improve its standards and to develop requirements and guidance on topics not currently addressed by IPSASs. This Consultation Paper (CP) seeks feedback on possible improvements to accounting for revenue and potential requirements and guidance for accounting for non-exchange expenses.

### Drivers for the projects on Revenue and Non-Exchange Expenses

- 1.4 The IPSASB initiated the projects for which this CP is an intermediate output in order to address the following areas where information for accountability and decision-making needs to be developed or potentially modified:
- (d) The operationalization of the exchange versus non-exchange distinction and the value of that distinction;
  - (e) The gap in the current IPSASB literature on non-exchange expenses leading to ambiguity and inconsistency of accounting policies in a highly significant area of expenditure;
  - (f) Implementation issues with IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers); and
  - (g) Convergence with International Accounting Standards Board (IASB) literature, which has diminished with the publication of IFRS 15, *Revenue from Contracts with Customers* in 2014.

In addition, the project assesses the alignment of the identified approaches with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

### *The Exchange versus Non-Exchange Distinction*

- 1.5 IPSAS 23 and other IPSASs require preparers to categorize transactions as exchange or non-exchange. This distinction is embedded in IPSASB's literature, as emphasized in the IPSASB's *Preface to the Conceptual Framework*. Most public sector activities are non-commercial in nature and therefore give rise to a large number of non-exchange transactions for which public sector entities do not receive equal, or approximately equal, consideration for services or other resources they provide.<sup>1</sup>
- 1.6 While preparers have not expressed fundamental disagreement with the distinction between exchange and non-exchange transactions, they have indicated that, at times, there are practical difficulties in making this categorization and that judgments on the categorization can be time-consuming. For example in areas like water provision it may be unclear whether a transaction is non-exchange—a tax—or exchange—a fee for a service. They have also questioned whether the separate presentation of information about exchange and non-exchange transactions provides useful information; there is anecdotal evidence that the distinction between exchange and non-exchange transactions is of limited interest to users.
- 1.7 Furthermore, operationalization of the definition can vary significantly. In particular, there is ambiguity over the meaning of the phrases “approximately equal value” and “directly giving” in the definitions of an “exchange” and a “non-exchange” transaction. The categorization can be particularly difficult for public sector entities that operate under a purchaser-provider model in which they receive funding from another public sector entity to provide goods or services to members of the public. Taken to one extreme, it can be argued that all transactions that a non-commercially-oriented public sector entity enters into are of a non-exchange character. This notion is based on the premise that a public sector entity is not involved in activities for its own direct benefit, but, rather, engages in transactions on behalf of its citizens and other constituents. The counterpoint to this argument is the notion that virtually all transactions of a public sector entity are fundamentally exchange in nature. This is because a public sector entity will only enter into transactions in furtherance of its objectives.

### *Gap in the current IPSASB Literature on Non-Exchange Expenses*

- 1.8 While a number of IPSASs provide guidance on the recognition of specific exchange expenses and liabilities<sup>2</sup>, there is very little guidance on the recognition of expenses and liabilities arising from non-exchange transactions, and no equivalent to IPSAS 23, which deals with non-exchange expenses. A consequence is that there is ambiguity and inconsistency in developing accounting policies in a highly significant area of expenditure, including the provision of major services to the community and transfers between different levels of government
- 1.9 The IPSASB has a current project to develop requirements and guidance for social benefits provided by public sector entities. The IPSASB issued a Consultation Paper, *Recognition and Measurement of Social Benefits*, in July 2015 and is currently considering the responses. An Exposure Draft of an IPSAS on Social Benefits will be issued in 2017. While this will be a major development, an IPSAS on Social Benefits will only partially fill the overall ‘gap’ on non-exchange expenses. In fact the development of a narrower definition of “social benefits”<sup>3</sup>, aligned more closely with statistical

<sup>1</sup> The full definition of an exchange and a non-exchange transaction are given in Chapter 2

<sup>2</sup> See for example IPSAS 13, *Leases*, and IPSAS 39, *Employee Benefits*

<sup>3</sup> The current definition is: Social benefits are benefits that are provided by a public sector entity:

(a) To address the needs of society as a whole;

accounting definitions, and therefore excluding areas such as the universal provision of healthcare and education makes the development of requirements and guidance for non-exchange expenses not within the definition of social benefits more pressing.

- 1.10 Issued in October 2002, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, was drawn from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. IPSAS 19 can be used as a source of guidance for the recognition of provisions for non-exchange expense transactions and has been used to develop accounting policies more broadly for non-exchange expenses. However, it was not developed for non-exchange transactions. This is reflected in the fact that, although IPSAS 19 does not have a blanket exclusion of all non-exchange expenses from its scope it explicitly excludes social benefits provided in non-exchange transactions. In addition, IPSAS 19 only deals with provisions – that is liabilities of uncertain timing and amount – rather than with liabilities and expenses more broadly. In dealing with non-exchange expenses IPSAS 19 therefore has limitations.

#### *IPSAS 23 Implementation Issues*

- 1.11 IPSAS 23 was issued in December 2006, for application in annual financial statements covering periods beginning on or after June 30th, 2008. Preparers have identified a number of practical implementation issues, in particular:
- (a) Stipulations (the distinction between conditions and restrictions) and particularly time requirements related to:
    - (i) Multi-year financing
    - (ii) Taxation, received in advance of the period in which it is intended to be used
  - (b) Capital grants; and
  - (c) Services in kind.
- 1.12 Preparers argue that IPSAS 23 is too restrictive in not allowing revenue to be recognized over time when funding is received for a specific purpose, but there is no return obligation. Some also argue that there is a difference between the consumption of resources rather than the more straightforward elapsing of time. Therefore if 65% of a two year grant is consumed in year one in the specific provision of a service and 35% in year two there is a view that this should be reflected in the pattern of revenue recognition. This may be different to a two year grant to finance general activities where there is no clear consumption pattern.
- 1.13 Taxation particularly gives rise to the identification of a taxable event, which can be at a number of points, some of which may be prior to the period for which the tax payment is intended to finance activities. This causes tension between recognizing revenue when the recipient entity gains control of the resources and accruing revenue over the period for which taxation is intended to finance activities.

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- (b) To mitigate the effect of social risks;
  - (c) Directly to specific individuals and/or households who meet eligibility criteria related to the mitigation of the effect of social risks, rather than being universally accessible; and
  - (d) In cash or in kind.

Addressing the needs of society as a whole does not require that each benefit covers all members of society (paragraphs AG3–AG9 provide additional guidance).

- 1.14 For capital grants there is an issue over how revenue should be recognized. There are a number of potential points– on receipt of funding, over the course of construction, when construction is completed or over the useful life of the asset. There can also be issues with return obligations where funders specify that a physical asset is used for a particular purpose over its useful life and there is a requirement that the resources are returned if the asset ceases to be used for that specified purpose.
- 1.15 Services in kind are highly significant for a number of entities, particularly some international organizations. Currently IPSAS 23 permits, but does not require entities to recognize services-in-kind as an asset and revenue. Some take the view that this option impairs comparisons between entities. Chapter 4 considers whether this requirement should be modified.

*Convergence with IASB literature following the issue of IFRS 15*

- 1.16 In May 2014 the International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*. IFRS 15 replaces IAS 18, *Revenue* and IAS 11, *Construction Contracts* with an effective date of January 1 2018. IFRS 15 also replaces a number of interpretations<sup>4</sup>. IPSASB's current standards–IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts*–are based on IAS 18 and IAS 11. Therefore the replacement of these standards by IFRS 15 has reduced convergence between the IPSASB's and IASB's literature.
- 1.17 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 reflects the transfer of control of the asset to the customer. The amount of revenue recognized is equal to the consideration the entity is entitled to for satisfying the performance obligation. This performance obligation approach represents new thinking on the recognition of exchange revenue. This new thinking also provides the opportunity to re-evaluate IPSASB's requirements and guidance for non-exchange revenue transactions. In particular it raises the question of whether categorizing transactions according to whether they contain performance obligations is more straightforward than distinguishing exchange and non-exchange transactions and whether such a categorization provides more useful information to users.

**Scope and Interaction with Other Projects and Pronouncements**

- 1.18 The revenue transactions within the scope of this CP are those currently in the scope of IPSAS 9, IPSAS 11 and IPSAS 23 with one exception. Revenue that arises from the use by others of entity assets yielding interest, royalties, and dividends or similar distributions currently within the scope of IPSAS 9 is outside the scope of this CP. Such transactions are being considered in the separate project to update IPSASB's standards on financial instruments–IPSAS 28, *Financial Instruments: Presentation*; IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosure*. Exchange expense transactions are outside the scope of this CP.
- 1.19 Transactions that are in the scope of the IPSASB's Social Benefits project are not included in the scope of this CP. Transactions that are in the scope of the current IPSASB projects on leases, public sector specific financial instruments, and financial instruments, are also outside the scope of this CP, as are transactions within the scope of IPSAS 40, *Public Sector Combinations*.

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<sup>4</sup> These interpretations are SIC 31, *Revenue: Barter Transactions Involving Advertising Services*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for Construction of Real Estate*, and IFRIC 18, *Transfers of Assets from Customers*

## Consultation Paper Structure

- 1.20 The CP covers both revenue and non-exchange expenses because variants of two approaches outlined and evaluated—the exchange/non-exchange approach and the public sector performance obligation approach—are applicable to revenue and non-exchange expense transactions. The IPSASB decided that the development of separate Consultation Papers would include the duplication of a considerable amount of material, which would be unhelpful to readers. Considering both revenue and non-exchange expense transactions in the same CP facilitates an evaluation of the extent to which the options identified lead to consistent accounting approaches for accounting for revenue and non-exchange expenses.
- 1.21 Chapter 2 outlines the current approaches to revenue recognition in IPSASB's own literature (IPSAS 23, IPSAS 9 and IPSAS 11) as well as the new revenue recognition model in IFRS 15.
- 1.22 Chapter 3 categorizes public sector transactions according to whether they contain performance obligations and, if so, whether transactions with performance obligations would be within the scope of IFRS 15. The chapter also outlines the IPSASB's approach towards such transactions and also to transactions that do not contain performance obligations.
- 1.23 Chapter 4 considers how refined versions of the approaches outlined in Chapter 2 can be applied to non-exchange revenue transactions and also considers how to address some of the implementation issues with IPSAS 23.
- 1.24 Chapter 5 considers the types of transactions encompassed by non-exchange expenses. It evaluates, the extent to which accounting requirements for non-exchange expenses could be based on the requirements in IPSAS 19, or whether new guidance, paralleling the revenue recognition approach derived from IFRS 15 or the revenue recognition approach in IPSAS 23, should be developed.
- 1.25 Chapter 6 considers measurement of revenue and non-exchange transactions and other issues related to non-contractual receivables and non-contractual payables and particularly focuses on subsequent measurement.
- 1.26 The Consultation Paper does not consider requirements and guidance related to presentation. The IPSASB will consider presentation<sup>5</sup> if and when the component projects reach the Exposure Draft stage.

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<sup>5</sup> The Conceptual Framework states that presentation is the selection, location and organization of information that is reported in general purpose financial reports. The Conceptual Framework distinguishes display and disclosure. In the context of the financial statements display relates to the items on the face of the financial statements and disclosure relates to the notes to the financial statements.

## 2. Current Revenue Recognition Standards

### Introduction

- 2.1 This Chapter summarizes current approaches to revenue recognition in the literature of the IPSASB and the IASB. The chapter contrasts the exchange/non-exchange approach which underpins IPSAS 9, IPSAS 11 and IPSAS 23 and the performance obligation approach that is reflected in IFRS 15.

### Definitions

- 2.2 Currently, the definitions of exchange and non-exchange transactions in the IPSASB's literature are:

#### **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."

### Non-Exchange Transactions

#### *IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers)*

- 2.3 Issued in December 2006, IPSAS 23 prescribes requirements for the financial reporting of revenue from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. IPSAS 23 provides guidance on the identification of contributions from owners but does not provide requirements for their accounting. IPSAS 23 includes high level and separate guidance on revenue recognition for taxes and transfers, the two most significant sources of non-exchange revenue for many governments and other public sector entities. For taxes IPSAS 23 defines the taxable event as the "event that the government, legislature, or other authority, has determined will be subject to taxation." The taxable event is the point at which an asset in respect of taxes is recognized if recognition criteria are met. IPSAS 23 provides high level guidance on the taxable event for a number of types of tax<sup>6</sup>, noting that it is essential for preparers to analyze the taxation law in their jurisdictions to determine the taxable event. IPSAS 23 acknowledges the following examples of transfers – grants, debt forgiveness, fines, bequests, gifts, donations and goods and services in-kind – and provides commentary on each.
- 2.4 As its title indicates the primary determinant of whether a revenue transaction is within the scope of IPSAS 23 is whether it is exchange or non-exchange in character. IPSAS 23 acknowledges that there might be transactions that have an exchange or non-exchange component, and groups of transactions that are a combination of exchange and non-exchange transactions. IPSAS 23 uses an illustrative example of funding from a multi-lateral development agency that includes a grant and a concessionary loan with market and off-market components. Accounting for the exchange

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<sup>6</sup> Income tax, value-added tax, good and services tax, customs duty, death duty and property tax.



component of a transaction, or exchange transactions within a broader group of transactions, will be in accordance with another IPSAS. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.

- 2.5 IPSAS 23 states that an inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the transaction. Therefore, under IPSAS 23, an entity first determines whether an asset should be recognized, based on the inflow meeting the asset definition and recognition criteria. The entity then determines whether there are any liabilities related to the transaction.
- 2.6 In determining whether a transaction, or group of transactions, gives rise to liabilities IPSAS 23's definition of stipulations on transferred assets (hereafter stipulations), and the sub-categorization of stipulations into restrictions on transferred assets (hereafter restrictions) and conditions on transferred assets (hereafter conditions), is central. IPSAS 23 defines stipulations as "terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity".
- 2.7 Conditions require that the entity return the resources to the transferor if the condition is breached. Therefore, when a recipient of resources initially recognizes an asset that is subject to a condition, the recipient incurs a present obligation to transfer economic benefits or service potential to third parties. In such circumstances the recipient also recognizes a liability. The revenue recognized for such a transaction is the net amount of the asset and liability. As the entity satisfies the conditions related to the inflow of resources it reduces the carrying amount of the liability and recognizes revenue equal to the amount of the reduction.
- 2.8 Restrictions are defined as stipulations that limit or direct the purposes for which a transferred asset may be used. Restrictions do not specify that resources have to be returned to the transferor if they are not used as specified. Consequently, a recipient of resources with restrictions, but no conditions, does not recognize a liability, but recognizes revenue as the gross amount of the inflow of resources. IPSAS 23 acknowledges that where there are breaches of restrictions, the transferor, or another party, may have the option of seeking a penalty against the recipient by legal or administrative processes. Such actions may result in a direction that the entity fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. However, IPSAS 23 explains that any such penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.
- 2.9 IPSAS 23 includes the following measurement requirements:
  - (a) An asset acquired through a non-exchange transaction is initially measured at fair value at the date of its acquisition;
  - (b) A liability related to a condition(s) on a transferred asset is measured at the best estimate of the amount acquired to settle the present obligation at the reporting date; and
  - (c) Revenue from non-exchange transactions is measured at the amount of the net increase in net assets recognized by the entity.
- 2.10 IPSAS 23 does not provide requirements or guidance on measurement subsequent to initial recognition. Chapter 6 of this CP discusses subsequent measurement and also considers measurement at initial recognition in more detail.

## Exchange Transactions

### *IPSAS 9, Revenue from Exchange Transactions*

- 2.11 IPSAS 9, *Revenue from Exchange Transactions*, was issued in July 2001. IPSAS 9 provides specific requirements and guidance on the recognition of revenue from the sale of goods, rendering of services, and the use by others of entity assets yielding interest, royalties, and dividends or similar distributions. Recognition of revenue is based on the following principles:
- (a) **Rendering of services:** stage of completion.
  - (b) **Sale of goods and services:** the risk and rewards of ownership of the goods.
  - (c) **Interest:** a time proportion basis taking into account the effective yield on the asset.
  - (d) **Royalties:** as earned in accordance with the substance of the relevant agreement.
  - (e) **Dividends or similar distributions;** when the shareholder's or entity's right to receive payment is established.
- 2.12 Revenue is measured at the fair value of the consideration received or receivable.
- 2.13 IPSAS 9 is primarily drawn from IAS 18, *Revenue*. While there are differences of terminology and some additional commentary in IPSAS 9, the only significant substantive difference is that the definition of revenue adopted in IPSAS 9 does not include a reference to ordinary activities—this reflects a view that it is not straightforward to determine what an ordinary activity is in the public sector, particularly for multi-functional entities. The accounting treatments in the two standards are the same. IAS 18 will be replaced by IFRS 15 for accounting periods after January 1 2018.

### *IPSAS 11, Construction Contracts*

- 2.14 IPSAS 11, *Construction Contracts*, was also issued in July 2001. IPSAS 11 prescribes the accounting treatment of costs and revenue associated with construction contracts in the financial statements of the contractor.
- 2.15 IPSAS 11 provides a definition of construction contracts and requirements and guidance on the allocation of contract revenue and contract costs to accounting periods in which construction work is performed. Recognition of contract revenue and expense is based on the “stage or percentage of completion” approach when the outcome of the construction contract can be estimated reliably. If such an outcome cannot be estimated reliably, revenue is recognized only to the extent of recoverable contract costs.
- 2.16 IPSAS 11 was primarily drawn from IAS 11, *Construction Contracts*. IPSAS 11 defines a construction contract, provides further definitions of “a cost plus or a cost-based contract”, a “fixed price contract” and a “contractor” and prescribes the accounting treatment of costs and revenue associated with construction contracts.
- 2.17 In addition to differences of terminology IPSAS 11 includes modifications to reflect the fact that, in the public sector, construction contracts may be on a non-commercial basis. For example, the IAS 11 definition of a “cost plus contract” is modified to include “cost-based contracts”, with no profit margin. Implementation guidance explains how the cost of completion approach is applied to non-commercial contracts. IPSAS 11 also acknowledged that arrangements can involve three parties with the third party providing funding and that, where funding in excess of that specified in the construction contract will be provided from an appropriation or other third party source, it is not necessary to

recognize an expected deficit as an immediate expense. IAS 11 will be replaced by IFRS 15 for accounting periods after January 1, 2018.

## IASB Literature

### *IFRS 15, Revenue from Contracts with Customers*

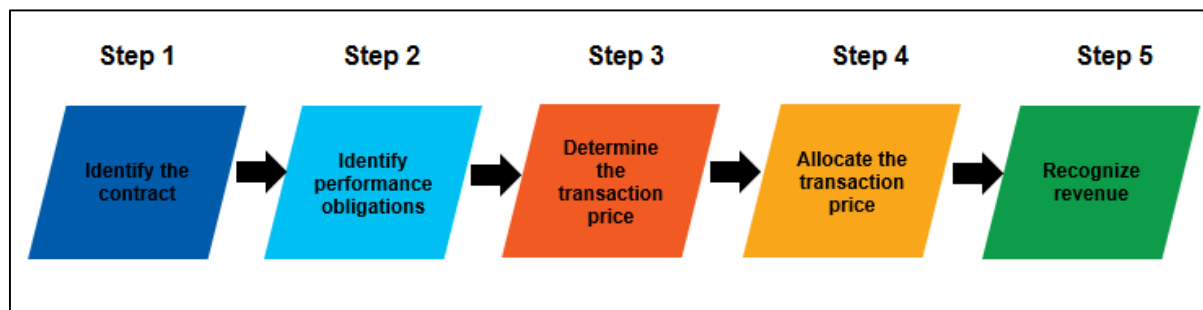
2.18 IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014. In September 2015 the IASB deferred the effective date by a year to January 1, 2018. In April 2016 the IASB issued *Clarifications to IFRS 15, Revenue from Contracts with Customers*, which provided clarifying amendments and some transitional reliefs. These clarifying amendments did not modify the principles underlying IFRS 15.

2.19 The core principles of the IFRS 15 performance obligation approach are:

- (a) Revenue should be recognized to reflect the transfer of control of promised goods or services (performance obligations) to the customer; and
- (b) The amount of revenue recognized should be equal to the consideration that the entity is entitled to for satisfying those performance obligations.

2.20 The core principles of the performance obligation approach are explained in 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 the customer at the amount to which the entity expects to be entitled. The five-step revenue model is important, not simply to a converged version of IFRS 15, but also to the Public Sector Performance Obligation Approach discussed in Chapter 3, for which it provides the principles. The model is presented diagrammatically below and then the five steps are discussed.

#### 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:

- a. The parties to the contract have approved the contract and are committed to perform their respective duties;
- b. Rights to goods and services to be transferred and payment terms can be identified;
- c. The contract has commercial substance; and

d. 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 takes account 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).

2.21 Compared with IAS 18, 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. 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. When the entity becomes entitled to payment, it recognizes a receivable.

2.22 An underlying principle of the revenue recognition model in IFRS 15 is that revenue is not recognized until control of the promised goods or services is transferred to the customer. The concept of transferring control in a revenue transaction is more easily envisaged for the sale of goods (described as transferring control of assets). However, the performance obligation approach treats both goods and services as 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.

2.23 Under the IFRS 15 performance obligation approach, performance obligations may be satisfied:

- (a) Over time (typically for promises to transfer services to a customer); or
- (b) At a point in time (typically for promises to transfer goods to a customer).

- 2.24 IFRS 15 allows for the recognition of revenue over time, if one of the following criteria is met:
- (a) The customer simultaneously receives and consumes the benefits provided as the performance obligations are performed;
  - (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; or
  - (c) 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.
- 2.25 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.
- 2.26 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.
- 2.27 When performance obligations are satisfied at a point in time, an entity is required to form a judgement as to when control of the goods or services are transferred to the customer. The indicators in IFRS 15 for determining the transfer of control at a point in time include (but are not limited to):
- (a) The entity has a present right to payment for the asset;
  - (b) The customer has legal title;
  - (c) The entity has transferred physical possession to the customer;
  - (d) The customer has significant risks and rewards of the ownership of the asset; or
  - (e) The customer has accepted the asset.
- 2.28 IFRS 15 contains application guidance on whether an entity arranging for the provision of goods or services by another party is a principal or an agent. Subject to qualifications on very temporary control the high level test is whether the entity controls a promised good or service before the entity transfers that good or service to a customer. This is complemented by a series of illustrative indicators that an entity is an agent, such as that another party is primarily responsible for fulfilling the contract, the entity does not have discretion in pricing, the entity's consideration is in the form of a commission and the entity is not exposed to credit risk.
- 2.29 In summary, the main characteristics of a revenue transaction within the scope of IFRS 15 are:
- (a) There has to be a customer who receives the benefits of delivered goods or services, described as the satisfaction of performance obligations;
  - (b) The performance obligations can be identified;
  - (c) The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined;
  - (d) The performance obligations are established through a legal contract, which creates enforceable rights and obligations between the parties;
  - (e) The contract has commercial substance;
  - (f) Control of the promised goods or services is transferred to the customer;

- (g) The transaction price can be allocated to the performance obligations in the contract; and
  - (h) Revenue is recognized by reference to when (or as) control of the promised goods or services are transferred to the customer
- 2.30 Chapters 3 categorizes public sector transactions and makes proposals for the approach to (a) transactions which meet the definitions and scope of IFRS 15 and (b) transactions which do not contain performance obligations. Chapters 4 and 5, re-express the IFRS 15 Performance Obligation Approach to develop a performance obligation approach for a broader range of public sector transactions.

### 3. Analyzing Public Sector Transactions with Reference to the IFRS 15 Performance Obligation Approach

- 3.1 This Chapter introduces three broad categories of public sector revenue and non-exchange expense transactions based on whether such transactions include performance obligations—either as defined in IFRS 15 or in another form. The categories have been developed to allow further consideration of the approaches described in this CP, in particular the extent to which performance obligation approaches can be applied to public sector transactions. The categorization simplifies the real world. In practice, there is likely to be a spectrum of transactions—at one end transactions with no performance obligations, at the other end transactions with identifiable and enforceable performance obligations, with many transactions lying somewhere in between. Despite these limitations the categories are useful in facilitating an evaluation of the extent to which a performance obligation approach can be applied to public sector transactions.
- 3.2 The chapter concludes by providing IPSASB's proposed approach for two of these categories—Category C and Category A transactions. The possible approaches for Category B transactions are considered in subsequent chapters.
- 3.3 The IPSASB has categorized transactions as follows:
  - (a) Category A—Revenue and non-exchange expense transactions with no performance obligations. For example, general taxation receipts and inter-governmental transfers, such as non-specific and non-earmarked grants. Such grants may be provided to finance the ongoing activities of multi-functional entities rather than be linked to particular programs.
  - (b) Category B—Revenue and non-exchange expense transactions that contain performance obligations, but those performance obligations do not have all the characteristics of a transaction within the scope of IFRS 15. This category includes both exchange and non-exchange revenue transactions (as currently defined in IPSAS 9) as well as non-exchange expense transactions. Category B also includes 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).

An example of such a tripartite arrangement is a grant from a central government department to a local government health provider to deliver a vaccination program to the community.

- (c) Category C—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. The key characteristic of a Category C transaction is a contract with a customer which establishes identifiable and enforceable performance obligations.

An example is the delivery of contracted professional services by a public sector entity to other public sector entities at market rates.

#### Approach to Category C Transactions

- 3.4 The IPSASB has an objective of convergence with IASB Standards, where appropriate. Therefore, for revenue transactions in the public sector, which are similar in nature and substance to for-profit

revenue transactions, the IPSASB considers that the standards-level requirements and guidance of the IPSASB and IASB should be converged and provide the same outcomes.

- 3.5 The definition of revenue in the IPSASB's Conceptual Framework is: *Increases in the net financial position of the entity, other than increases arising from ownership contributions*. The IPSASB considers that the definition of income<sup>7</sup> in IFRS 15 is consistent with this definition.
- 3.6 The IPSASB is of the view that the quality of accounting for transactions currently addressed in IPSAS 9 and IPSAS 11 will be enhanced by development of a new IPSAS, primarily drawn from IFRS 15. A converged approach is also considered to be more efficient for consolidation purposes in jurisdictions where commercially-oriented public sector entities report on an IFRS-basis.
- 3.7 The development of standards-level requirements and guidance converged with IFRS 15, for the purpose of application to Category C transactions, will require modification to allow the approach to be applied to public sector transactions. The IPSASB considers the extent of the modifications will be generally limited to changes of terminology rather than substance. In developing an IPSAS based on IFRS 15 to deal with Category C transactions the IPSASB will apply *The Process for Modifying IASB Documents* (also known as the Rules of the Road).
- 3.8 Modifications in developing an IPSAS primarily drawn from IFRS 15 may include:
- (a) Modifying the IFRS 15 definition of "revenue" to ensure consistency with IPSASB's Conceptual Framework definition, including the removal of references to "ordinary activities." The current IPSASB literature does not generally make a distinction between ordinary activities and activities outside the ordinary course of operations, primarily because of the multi-functional nature of many public sector entities;
  - (b) Modifying the recognition requirements for expenses arising from construction contracts where there are third party funding arrangements such as those acknowledged in IPSAS 11;
  - (c) Guidance to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and ownership contributions; and
  - (d) That rights and obligation are not only established through legal contracts, but can also be established through equivalent enforceable binding arrangements.

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<sup>7</sup> The IFRS definition of income is "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."



**Preliminary View 1**

The IPSASB considers that it is appropriate to replace IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* with an IPSAS primarily drawn from IFRS 15, *Revenue from Contracts with Customers*. Such an IPSAS will address Category C transactions that:

- (a) Involve the transfer of promised goods or services to customers as defined in IFRS 15; and
- (b) Arise from a contract (or equivalent binding arrangement) with a customer which establishes identifiable and enforceable performance obligations.

Do you agree with the IPSASB's Preliminary View 1? Please give your reasons

**Approach to Category A Revenue Transactions**

- 3.9 Because Category A transactions do not contain performance obligations an approach to their accounting based on the identification and fulfillment of performance obligations is obviously impractical, Requirements and guidance for Category A revenue transactions will be provided in a revised IPSAS 23 or an IPSAS that is developed from IPSAS 23 and incorporates IPSAS 23 principles. The nature of the changes that might be made to IPSAS 23 is discussed in Chapter 4.

**Preliminary View 2**

Because Category A transactions do not contain performance obligations, IPSASB considers that these transactions will need to be addressed in either a revised IPSAS 23 or a standard incorporating IPSAS 23 principles.

Do you agree with the IPSASB's Preliminary View 2? Please give your reasons.

**Approach to Category B Transactions**

- 3.10 Chapter 4 considers two approaches for dealing with Category B transactions—a Public Sector Performance Obligation Approach and the Exchange/Non-Exchange Approach with a modified IPSAS 23.

## 4. The Public Sector Performance Obligation Approach, the Exchange/Non-Exchange Approach and Potential Revisions to IPSAS 23

### Introduction

- 4.1 This chapter discusses recognition options for Category B transactions which were outlined in Chapter 2— that is transactions that involve the satisfaction of performance obligations, which do not contain all the characteristics required by IFRS 15. The chapter then addresses implementation issues related to IPSAS 23 and identifies possible solutions. As noted previously, if a performance obligation approach is adopted for Category B transactions, IPSAS 23 will provide requirements and guidance for Category A transactions that do not contain performance obligations. IPSAS 23 (or an IPSAS incorporating IPSAS 23 principles) will therefore continue to be an essential part of the IPSASB's literature, regardless of whether a performance obligation approach is ultimately adopted. Consequently, the IPSASB will address these issues, regardless of whether it decides to proceed with a broader performance obligation approach for Category B transactions. The chapter concludes by summarizing the advantages and disadvantages of a performance obligation approach and retention of the exchange/non-exchange approach for Category B transactions

### The Public Sector Performance Obligation Approach for Revenue

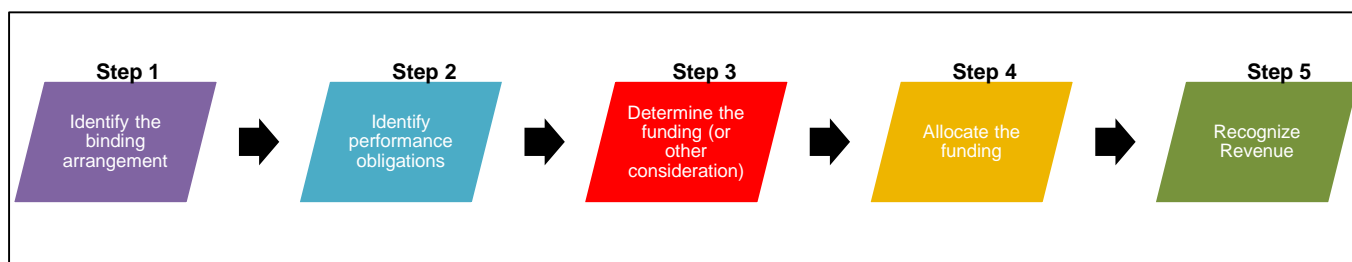
- 4.2 The performance obligation approach in IFRS 15 was developed for commercial transactions. The development of a performance obligation approach in a public sector environment, gives rise to a number of challenges when applied to non-commercial transactions.
- 4.3 In a public sector revenue transaction, in contrast to a private sector for-profit transaction, there may be:
- (e) Less detail on the specifications of the goods or services (hereafter services when referring to the public sector) to be supplied;
  - (f) Three parties involved instead of one supplier and one customer. Entities may receive funding from one party to provide services to another party—resource provider, resource recipient and resource beneficiary. While IFRS 15 does envisage such circumstances—for example where flowers are delivered to a third party rather than to the individual paying for them—the volume and scale of such transactions is far greater in the public sector;
  - (g) Less clarity when control of services has been transferred to another entity or individual; and
  - (h) More variation and uncertainty about enforceability. This is because many agreements will not be legal contracts. Consequently there may be less detail in the agreement on enforcement mechanisms, and fewer cases where agreements are enforced.

### *The Five-Step Approach in a Public Sector Context*

- 4.4 The IPSASB considers that the IFRS 15 revenue recognition model is an appropriate reference point to explore the extent to which a performance obligation approach can be developed for public sector revenue transactions involving the satisfaction of performance obligations, which do not meet the criteria in IFRS 15.
- 4.5 This section of the CP retains the Five-Step IFRS approach as the basis of what is described as the Public Sector Performance Obligation Approach (PSPOA). For each of the five steps, the IFRS

characteristic is described. Then, the public sector characteristics that need to be taken into account in order to modify the five steps and develop the PSPOA are discussed.

*The Public Sector Performance Obligation Approach for Revenue: The Five Steps*



**Step 1 Identify the binding arrangement**

**IFRS 15 characteristic**

- 4.6 The first step in the five-step revenue recognition model in IFRS 15, *Revenue from Contracts with Customer*, is “the entity identifies the contract with the customer”. Because IFRS 15 deals with contractual arrangements enforceability will be effected through commercial law in a particular jurisdiction – which is likely to be the law of contract (or equivalent). The Basis for Conclusions of IFRS 15 does acknowledge that certain contractual terms may be implied through business practice rather than explicit terms.<sup>8</sup> However, acknowledging an implied term does not negate the fundamental point that arrangements within the scope of IFRS 15 are enforceable, i.e. both parties to the contract have legal redress in the event of a breach.

**Step 1 re-expressed for the public sector**

- 4.7 In the public sector many arrangements for the provision of resources are non-contractual, so a first step that solely focuses on contracts is of limited value. Furthermore, the IPSASB’s Conceptual Framework acknowledges that “there are jurisdictions where government and public sector entities cannot enter into legal obligations, because for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework.” For this reason and the fact that many agreements are not contractual this first step been relabeled “Identify the binding arrangement”
- 4.8 The IPSASB has considered a view that the range of arrangements in the public sector means that a performance obligation approach should be applied to arrangements where the resource provider does not have an “enforceable” right to the return of resources. The IPSASB is of the view that enforceability is a key attribute of any approach based on the fulfillment of performance obligations and that it is questionable whether performance obligations that are not enforceable have substance. However, the IPSASB takes the view that the interpretation of enforceability should reflect the public sector context, so that enforceability can be reflected by a range of non-contractual mechanisms, such as cabinet and ministerial decisions, appropriations and deductions from future funding for the same program. In assessing enforceability the emphasis should be on the ability of the transferor of

<sup>8</sup> See paragraphs BC35 and BC87 of IFRS 15

resources to enforce the return of resources in the event of non-fulfillment of a performance obligation, rather than an overemphasis on the past record of enforcement. Enforceability does not extend to reputational risk or economic compulsion. Transactions with performance obligations that are not enforceable are treated like Category A transactions in accordance with the categorization scheme in Chapter 2. This discussion of enforceability can also be applied to the analysis of conditions in IPSAS 23.4.8.

Step 2 Identify the performance obligations, (which benefit either the resource provider or resource beneficiary)

IFRS 15 characteristic

- 4.9 IFRS 15 requires the identification of the customer in each contractual arrangement. This is a key step in the IFRS 15 approach because revenue is not recognized until control of promised goods or services is transferred to the customer. 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.
- 4.10 IFRS 15 requires the identification of “distinct” 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 is distinct.
- 4.11 The objective of identifying each distinct performance obligation in 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.

Step 2 re-expressed for the public sector

- 4.12 The nature of revenue transactions in the public sector often means that it is not possible to identify specific recipients. The services provided by public sector entities are often determined by their legislative mandate and provided to a wide range of individuals, households and other entities. Further, services may be provided collectively rather than to specific individuals or households; for example, defense, policing services and street lighting (discussed in more detail in Chapter 5).
- 4.13 Public sector transactions often involve three parties—the resource provider which provides the funding (or other consideration), the resource recipient, which receives the funding (or other consideration) and is responsible for the delivery of services, and the resource beneficiary of those services, which can include individuals or the wider community. The resource provider in the public sector will often not receive the services in the performance obligation. However, in the public sector, the resource provider is often viewed as receiving the benefits of satisfied performance obligations delivered to third parties (beneficiaries). This is because the resource provider has the ability to direct who receives services in those performance obligations and provision of the services is in accordance with the resource provider’s objectives. As with IFRS 15 transactions there may be a question whether the entity providing the services is acting as an agent, rather than a principal—some of the indicators highlighted in paragraph 2.28 might be relevant to such a determination. A key principle of the PSPOA is the recognition of a liability when the resource recipient has received funding (or other consideration), but associated promised performance obligations have not yet been satisfied.

- 4.14 The IPSASB considers that the PSPOA will be appropriate for arrangements where each specific performance obligation can be identified. Under the PSPOA, 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 precision of promises to transfer goods or services in a for-profit context under IFRS 15, is different from the satisfaction of agreed performance obligations in the public sector. An example is the satisfaction of performance obligations in a capital grant arrangement, many of which will not involve the delivery of services.
- 4.15 The agreement must provide specific information regarding the nature, cost, value or volume of the agreed performance obligations so that each performance obligation can be separately identifiable. Determining when a performance obligation is specific and identifiable will often require a greater level of judgement in the public sector than for for-profit transactions. For example, an agreement where central government provides a grant to a local government health provider to support the provision of dental services may not clearly specify the services to be purchased or delivered. Nevertheless a performance obligation approach could be appropriate, when the performance obligations are identifiable and specific.
- 4.16 In the example above, a key indicator of whether there are separate and identifiable performance obligations in the arrangement is whether the resource recipient (entity receiving funding and accepting 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.
- 4.17 In contrast, when a central government provides funding to another public sector entity to support general operations, a public sector performance obligation approach will not be appropriate because there are no specific performance obligations on the use of funds. In substance, there are no separate or identifiable specific performance obligations in the arrangement, because all funding provided could be spent immediately or deferred to support operating costs in future reporting periods.
- 4.18 Under the PSPOA, if the performance obligations in 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..
- 4.19 The identification of separate performance obligations in an arrangement directly affects the timing of revenue recognition. 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 delayed revenue recognition.
- 4.20 In summary, the IPSASB considers that the performance obligation approach will be appropriate for arrangements involving three parties (resource provider, resource recipient, and resource beneficiary) when:
- (a) Performance obligations have been clearly identified; and
  - (b) The intended beneficiaries of those performance obligations have been clearly specified even though individual beneficiaries may not be identified.

#### **Specific Matter for Comment 1**

The CP considers the Public Sector Performance Obligation Approach is only appropriate when agreed performance obligations in an arrangement are “identifiable and specific”.

The main criterion 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 that the performance obligation has been satisfied.

- (a) Do you agree with the use of the term identifiable and specific?
- (b) Do you agree with the criterion for determining when a performance obligation is identifiable and specific?

If you think that the criterion is too restrictive or that additional guidance should be provided please provide suggestions for any amendments.

### Step 3 Determine the funding (or other consideration)

#### IFRS 15 characteristic

4.21 IFRS 15 assumes 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:

- (a) 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
- (b) The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services.

#### Step 3 re-expressed for the public sector

4.22 Both of these characteristics are not always applicable to public sector transactions involving the satisfaction of performance obligations. Therefore, the IPSASB has re-expressed the characteristics for the PSPOA.

The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised services to be delivered through satisfaction of the performance obligation

4.23 The IPSASB considers it appropriate that the PSPOA continues to be applicable to arrangements where the amount of funding is determined by the resource provider based on the level of agreed services to be delivered. Under the PSPOA, this characteristic could be described as an arrangement where it can be demonstrated that the amount of funding provided has been determined by the resource provider (the funder) in relation to the nature, cost, value or volume of the agreed performance obligations. In general terms, in order to apply the PSPOA, an entity will need to demonstrate a linkage between the amount of agreed funding and the satisfaction of performance obligations.

4.24 An indicator of whether a linkage between the amount of funding and performance obligations can be demonstrated will be whether the arrangement provides for the amendment of funding levels when agreed performance obligations are not met or are exceeded.

4.25 Another indicator of a linkage between the amount of funding and the performance obligations, is whether the amount of funding is conditional on the satisfaction of agreed performance obligations. If funding is unrelated to the satisfaction of performance obligations, the PSPOA will not be an appropriate revenue recognition model for these transactions.

- 4.26 In addition, if there is no linkage between the funding and performance obligations, it will be difficult to demonstrate that performance obligations are enforceable, because there are effectively no financial consequences for non-performance.

The amount of expected revenues reflects the amount to which the entity expects to be entitled for delivery of those services

- 4.27 In the private sector it is assumed that the amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for distinctly identifiable services. This is because commercial arrangements are entered into by a willing buyer and a willing seller.
- 4.28 In contrast the emphasis in the PSPOA is on the need for an arrangement to demonstrate that 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.
- 4.29 An arrangement within the scope, has to demonstrate a linkage between the funding provided to another entity and the agreed performance obligations.
- 4.30 The scope of the public sector performance obligation approach is limited to arrangements where the amount of funding:
- (a) Has been determined by giving consideration to the nature, cost, value or volume of the promised services to be delivered; and
  - (b) Is conditional on the delivery of promised services.

Step 4 Allocate the funding to each identifiable and specific performance obligation

IFRS 15 characteristic

- 4.31 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 it determines how much revenue will be recognized when (or as) performance obligations are satisfied.
- 4.32 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.

Step 4 re-expressed for the public sector

- 4.33 In the public sector, due to the integrated nature of the services provided, there may not always be stand-alone selling prices. Many public sector entities do not compete directly with private sector entities and may not set prices for services based on market considerations. However, many public sector entities receive funding in exchange for the satisfaction of performance obligations, which involve the delivery of services to the public. For example; funding from central government to other public sector entities to deliver education and health care services to the public. Under these

arrangements it can prove difficult to determine the stand-alone selling price of each identifiable and specific performance obligation in the funding arrangement.

- 4.34 In the PSPOA, the IPSASB considers 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.
- 4.35 If the allocation of the total amount of agreed funding for each identifiable and specific performance obligation cannot be estimated reliably on a cost of delivery basis, this indicates that it may not be appropriate to account for the arrangement in accordance with the PSPOA.

#### Donation components

- 4.36 When allocating the total amount of agreed funding in an arrangement, under the PSPOA, the first step required is the identification of any separately identifiable amounts of funding not related to the satisfaction of agreed performance obligations.
- 4.37 The amount of agreed funding not attributable to the satisfaction of performance obligations within an arrangement will need to be accounted for separately 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 requirements for Category A transactions.
- 4.38 The IPSASB considers the following indicators could be used to provide evidence that a component of the revenue funding is separate from the funding provided in exchange for satisfaction of performance obligations:
- (a) The customer or resource provider makes the entity aware that there was intended to be a donation component in the arrangement;
  - (b) The entity’s entitlement to retain the donation is not conditional on the satisfaction of performance obligations; and
  - (c) The amount of the donation component allocated to the non-exchange component can be separately identified and measured reliably.
- 4.39 Where both the existence and amount of the donation component is unclear, then the entire amount of funding is included in the agreed funding balance allocated across performance obligations.

#### **Specific Matter for Comment 2**

Do you agree that the cost of delivery approach is the appropriate method for allocating the total amount of funding (or other consideration) across identifiable and specific performance obligation?

If you think that there are alternative options please identify and explain them.

Step 5 Revenue is recognized when (or as) the resource recipient satisfies the performance obligation

#### IFRS 15 characteristic

- 4.40 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.



### Step 5 re-expressed for the public sector

- 4.41 In the public sector revenue transactions often include performance obligations in the form of a promises to complete certain activities to support the delivery of 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 funding (resource provider) or to specific individuals.
- 4.42 Under the PSPOA, the IPSASB considers 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, so this approach is not really a conceptual departure from IFRS 15.
- 4.43 The recognition of revenue as performance obligations are satisfied relies on the ability of the resource recipient (the entity which 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 is particularly important in arrangements where the wider public receives the benefits of satisfied performance obligations, rather than the resource provider directly.
- 4.44 Demonstrating the satisfaction of performance obligations is likely to be evidenced by the resource recipient 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).
- 4.45 Under the PSPOA, 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 the delivery of promised goods or services is received in advance of satisfying the performance obligation, then this will give rise to a liability of the resource recipient.

#### **Specific Matter for Comment 3**

Do you agree that the trigger for revenue recognition in the Public Sector Performance Obligation approach should be when the entity “satisfies the promised performance obligations”?

If you disagree please indicate what should be the trigger for revenue recognition and give your reasons?

#### **Applying the PSPOA to Common Public Sector Arrangements**

- 4.46 The table below indicates whether the PSPOA can be applied to some common public sector revenue transactions. It is supported by some fact patterns in Appendix A (To be tabled at meeting).

*Table 1 How the PSPOA Can be Applied to Some Common Public Sector Arrangements*

| Arrangements                  | Applicability   |
|-------------------------------|---|
| One Year Specific Grant       | <p>Applicable if the following characteristics are present:</p> <ul style="list-style-type: none"> <li>• Arrangement is enforceable</li> <li>• Arrangement contains identifiable and specific performance obligations that must be satisfied by the recipient</li> <li>• Funding can be allocated to each of the performance obligations</li> </ul>   |
| Capital Grants                | <p>Applicable if the following characteristics are present:</p> <ul style="list-style-type: none"> <li>• Arrangement is enforceable</li> <li>• Arrangement contains identifiable and specific performance obligations that must be satisfied by the recipient</li> <li>• Funding can be allocated to each of the performance obligations</li> </ul>   |
| Multi-Year Research Grants    | <p>Applicable if the following characteristics are present:</p> <ul style="list-style-type: none"> <li>• Arrangement is enforceable</li> <li>• Arrangement contains identifiable and specific performance obligations that must be satisfied by the recipient</li> <li>• Funding can be allocated to each of the performance obligations</li> </ul> <p>Not applicable if the research grant does not have clearly identified deliverables, whether to the resource provider or a resource beneficiary or if funding cannot be allocated to performance obligations.</p> |
| General (non-specific grants) | <p>Not applicable as such grants do not contain performance obligations. Account for under a revised IPSAS 23 or a new IPSAS incorporating IPSAS 23 principles.</p>   |

### Summarizing the Approach to Revenue Transactions Under the PSPOA

4.47 Table 2 summarizes the approach to the three categories of transactions outlined in Chapter 2 under the PSPOA.

*Table 2 Summary of approach to the three categories of transactions*

| Category | Description  |   |
|----------|--|---|
| A        | Revenue and expense transactions with no performance obligations.  | Address under modified IPSAS 23 or standard incorporating IPSAS 23 principles.  |
| B        | Revenue and expense transactions that contain performance obligations, but those performance obligations do not have all the characteristics of a transaction within the scope of IFRS 15. | Address under IPSAS for transactions with performance obligations not meeting the IFRS 15 criteria if such transactions can be addressed by applying the five step approach in the PSPOA e.g., if performance obligations are identifiable and specific and expected revenue will change as a result of changes to the nature, cost, value or volume of the promised services to be delivered through satisfaction of the performance obligation.<br><br>If the five step approach cannot be applied address under modified IPSAS 23 or standard incorporating IPSAS 23 principles. |
| C        | Revenue transactions that would be within the scope of IFRS 15.  | Address in an IPSAS primarily drawn from IFRS 15 to replace IPSAS 9 and IPSAS 11.   |

### **The Exchange/Non-Exchange Approach: Revised IPSAS 23**

- 4.48 As its name indicates under the exchange/non-exchange approach the current distinction between exchange and non-exchange transactions is retained as the primary determinant of accounting treatments. IPSAS 23 would therefore continue to provide requirements and guidance for both Category B transactions as well as Category A transactions— that is revenue transactions classified as non-exchange, regardless of whether they contain performance obligations. IPSAS 23 is summarized in Chapter 2.
- 4.49 The identification of performance obligations will be useful in distinguishing conditions and restrictions—as we have noted conditions reflect performance obligations. However, this is a secondary consideration following the initial decision whether a transaction is exchange or non-exchange in character. The retention of the Exchange/Non-Exchange approach will involve less change to existing IPSASB literature than adoption of the PSPOA.
- 4.50 As Chapter 2 has emphasized if IPSAS 23 is retained—either in its current guise or in a revised role in which it provides requirements and guidance for transactions without performance obligations—it will be important to address certain implementation issues identified in Chapter 1 that have been identified by preparers. The following section therefore address these issues:
- (a) Stipulations: Conditions and Restrictions
    - (i) Time requirements—government transfers received in advance of year for which intended; multi-year financing and any funding, particularly taxation, received in advance of the period in which it is intended to be used;

- (b) Capital Grants; and
- (c) Services in kind.

*Stipulations: Conditions and Restrictions*

- 4.51 As indicated in Chapter 1 and discussed in more detail in Chapter 2 IPSAS 23 defines stipulations and sub-categorizes stipulations into conditions and restrictions. As already noted some preparers find this approach inflexible. Practically the main implementation issue in IPSAS 23 arising from the distinction between conditions and restrictions has been the treatment of time requirements.

*Time Requirements*

- 4.52 The treatment of time requirements is probably the most controversial aspect of IPSAS 23. Currently time requirements are restrictions rather than conditions. Some preparers think that IPSAS 23 gives rise to accounting outcomes that do not present relevant and faithfully representative information or information that is understandable and promotes inter-entity comparisons. This is because IPSAS 23 requires the recipients of transferred resources to recognize both an asset and revenue unless an agreement contains conditions – that is to say there is both a performance obligation and a return obligation. Therefore resources transferred without conditions prior to the reporting period for which they are intended give rise to revenue at the point at which they are received and the recipient controls those resources. Currently, under IPSAS 23 the recipient would be required to recognize revenue and therefore ‘a day one gain’ even though the resource provider intends that the resources be used to finance activities in subsequent reporting periods.
- 4.53 The transactions that may be affected by this requirement include some of the most important resources that public sector entities receive to finance their activities—government transfers, taxation receipts and general multi-year grants. Consequently, unless there is a return obligation related to the resources if they are not used in a specified manner, government transfers, multi-year grant financing and taxation receipts received in advance of the period for which they are intended and controlled by the recipient are recognized when they are received. The result is that, for example, the resources from a five-year grant without conditions are recognized as revenue in one reporting period.
- 4.54 As discussed in Chapter 1 there is a view that the consumption of resources should be treated differently from the lapsing of time. Under this view a specific grant that leads to a clear pattern of consumption by the recipient should be treated differently from a general grant where the resources are on a lapse of time basis.

*Reclassifying time requirements as conditions*

- 4.55 The most seemingly straightforward solution to this issue is to reclassify time requirements as conditions, so that such requirements give rise to a liability of the recipient until the reporting period in which they are intended by the provider to finance activities. However, this would be inconsistent with IPSASB's Conceptual Framework and broader literature—it would involve modifying the definition of a condition on a transferred asset, so that it specifically includes time requirements regardless of whether transactions with time requirements include both a performance and a return obligation. This would result in obligations being recognized as liabilities which do not meet the liability definition in

the Conceptual Framework, because they do not involve an outflow of resources<sup>9</sup>. Therefore the IPSASB has strong reservations about simply reclassifying time requirements as conditions.

Would adoption of a performance obligation approach resolve or partially resolve this issue?

- 4.56 The adoption of a performance obligation approach would not resolve the issue of the inflexibility of the accounting treatment of time requirements, because, as we have discussed in Chapter 3, the IPSASB has formed a view that performance obligations have to be enforceable. The problem might be partially addressed by defining enforceability more flexibly, so that a larger number of mechanisms are considered enforceable, as suggested in paragraph 4.8. Similarly under IPSAS 23 if enforceability is defined more broadly the number of return obligations may increase, which might also increase the number of conditions and make it slightly easier for preparers to recognize liabilities. However, these remedies would be partial and would not really resolve the implementation difficulties that preparers have experienced.

Recognizing time requirements as other resources and other obligations

- 4.57 In the development of its Public Sector Conceptual Framework the IPSASB issued an Exposure Draft (ED), *Elements and Recognition in Financial Statements*, which proposed that deferred inflows and deferred outflows should be adopted as elements. The objective was largely to deal with the situation outlined above—entities which receive resources in non-exchange transactions for use in specified future reporting periods would recognize a deferred inflow, while entities that provide resources in non-exchange transactions for use in specified future reporting periods would recognize a deferred outflow.
- 4.58 Following consultation on that ED the IPSASB decided not to define deferred inflows and deferred outflows as elements. However, the IPSASB did accept 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.”<sup>10</sup> The IPSASB therefore acknowledged that there may be circumstances where there is a case for recognizing other economic phenomena that do not meet the definition of an element. The IPSASB 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.” At the time of approval of this Consultation Paper other resources and other obligations have not been used at standards-level.
- 4.59 One approach is therefore to accept that the receipt of resources with time requirements does not give rise to a liability of the recipient but that it is the public interest for the recipient to recognize an “other obligation”—this conveys to users of the financial statements that the recipient has resources that are intended for use in subsequent reporting periods. Conversely, the transferor of the resources no longer controls the resources and therefore cannot recognize an asset. However, the usefulness of the financial statements is enhanced by the transferor recognizing an “other resource”—this conveys to users that the entity has transferred resources that are intended for use in subsequent reporting periods.

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<sup>9</sup> The definition of a liability in the Conceptual Framework is: *A present obligation of the entity for an outflow of resources that results from a past event.*

<sup>10</sup> Conceptual Framework, Chapter 5.

- 4.60 Some argue that the use of other resources and other obligations is an over-drastic step. It might cause particular problems for jurisdictions where public sector entities report on a mixed group basis<sup>11</sup>, because other resources and other obligations do not have counterparts in IFRS. They may acknowledge that there is a problem, but consider that the solution is to use presentational means. These may include one or a combination of the following:
- (a) Note disclosures explaining that resources within accumulated surplus or deficit include resources that the transferor intends for use by the recipient in one or more future reporting periods;
  - (b) Disaggregation of net financial position (net assets/equity) to identify resources that the transferor intends to be used by the recipient in future years; and
  - (c) Taking resources to net financial position (net assets/equity) and recycling them to surplus/deficit in the year in which the transferor intends them to be used by the recipient.
- 4.61 Those who support these approaches consider that they preserve the integrity of the financial statements by only including the recognition of items that meet the definition of an element while providing users with the information that they need for accountability and decision-making purposes. Others think that presentational approaches do not indicate sufficiently clearly that transactions, such as multi-year year grants, are intended to finance activities for periods beyond the reporting period in which they are recognized.

#### **IPSASB Matter for Consideration 1**

Does the IPSASB wish to express a preliminary view on the issue of time requirements? If so, does the IPSAB favor the use of “other resources” and “other obligations” or the use of one or more presentational methods?

#### **Specific Matter for Comment 4**

Where an entity transfers resources to a recipient with time requirements, but no conditions do you:

- (a) Favor the use of other resources and other obligations to indicate to users that the transferor intends that the recipient uses the resources in one or more future reporting periods; or
- (b) Consider that the use of other resources and other obligations is unnecessary and support the use of one or more presentational mechanisms to provide information to users on transactions with time requirements.

Please explain your reasons.

#### *Capital Grants*

- 4.62 The main issue with capital grants is the pattern of revenue recognition. Revenue from capital grants is likely to be recognized in an uneven profile, dependent on whether the grant funding agreement includes restrictions, conditions or a mixture of the two. If the funding arrangement does not have conditions, revenue will be recognized as the grant becomes receivable; if the funding arrangement has conditions the pattern of recognition will be more “lumpy”. For example, if the condition attached to a grant for refurbishment of a building is that the grant is repayable up to the point at which that

<sup>11</sup> That is where non-commercial public sector entities report on IPSAS and commercial public sector entities report on IFRS.

building becomes operational, revenue would only be recognized at that point. The profile of revenue recognition would be very different to a grant that adopts a “stage of completion” approach in which conditions are met as parts of the building is completed. This has led some preparers to prefer an accounting treatment based on IAS 20, *Government Grants and Disclosure of Government Assistance*, in which revenue is either recognized in surplus or deficit on a systematic basis over the useful life of the asset financed by the grant or as an offset to a depreciation expense. The IPSASB does not support these treatments because they are not consistent with the definition of revenue in the Conceptual Framework.<sup>12</sup>

- 4.63 IPSASB has received feedback that the current requirements are ambiguous to apply for capital grants. In particular it may not be clear exactly what constitutes a condition. For example, some capital grants contain stipulations that the resources must be used to construct or acquire capital assets for delivery of specified services and that if use of the capital asset for delivery of those assets is discontinued the grant is repayable. The issue is whether such a stipulation is a condition, which may mean that a recipient entity must recognize a continuing liability that it does not derecognize, or a restriction. Can the entity argue that it can avoid repayment by continuing to use the asset for the provision of specified services? If a restriction, what should the pattern of recognition of the grant be?

Would adoption of a performance obligation approach resolve or partially resolve these issues?

- 4.64 Adoption of a performance obligation approach might bring more clarity on the obligations that the recipient is required to satisfy under the terms of the grant. However, performance obligations are likely to be the same as conditions under the exchange/non-exchange approach, so any improvement of accounting treatment is likely to be marginal. The IPSASB is therefore interested in obtaining more information about the issues that preparers have with accounting for capital grants.

#### **Specific Matter for Comment 5**

- (a) Has the IPSASB identified the main issues with capital grants?  
 (b) How do you think the IPSASB should modify IPSAS 23 to deal with capital grants?

If you think that there are other issues with capital grants please identify them.

#### *Services In-Kind*

- 4.65 Currently IPSAS 23 permits, but does not require, the recognition of services in-kind. The Basis for Conclusions (BC) of IPSAS 23 explains that many services in-kind do meet the definition of an asset, and should, in principle, be recognized. IPSAS 23.BC 25 acknowledges that there may be difficulties in obtaining reliable measurements. A further complicating factor is that services in-kind may not give rise to an asset because the reporting entity has insufficient control of the services provided and therefore of the resource. For these reasons the IPSASB concluded that entities should be permitted, but not required, to recognize services in-kind.
- 4.66 Some argue that the existence of options reduces comparability between entities and that the provisions related to services in-kind should be more clear-cut. As indicated in Chapter 1 services in-kind can be material for some international organizations. The Conceptual Framework has reaffirmed that services in-kind will often meet the definition of an asset. In this respect they do not differ from goods in-kind, which IPSAS 23 states should be recognized as assets when the goods are received,

<sup>12</sup> The definition of revenue in the Conceptual Framework is “increases in the net financial position of the entity, other than increase arising from ownership contributions.”

or there is a binding arrangement to receive the goods. Therefore the assumption should be that services in-kind should be recognized provided the entity can control the services provided and those services can be measured in a way that achieves the qualitative characteristics and takes account of the constraints of financial reporting. In most cases it will be feasible to obtain a viable measure of the services provided by reference to the cost of obtaining such services in an observable commercial transaction.

- 4.67 A contrary view is that for some entities the cost of obtaining such information is greater than the benefit to users of the information. Therefore the current requirement in IPSAS 23 that permits, but does not require, the recognition of services in-kind should be retained.
- 4.68 The Australian Accounting Standards Board (AASB) has recently developed an exposure draft on accounting for the income of not-for-profit entities.<sup>13</sup> This includes a section on volunteer services. The AASB requires volunteer services to be recognized as an asset by public sector entities when the fair value can be measured reliably and the services would have been purchased if they had not been donated. Where the services would not have been purchased public sector entities do not recognize volunteer services. The IPSASB welcomes views as to whether this is a useful distinction that the IPSASB should consider in modifying the requirements for services in-kind.

#### Specific Matter for Comment 6

Do you consider that the IPSASB should:

- (a) Modify the requirements of IPSAS 23 to require services in-kind that meet the asset definition and can be measured they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in general purpose financial reports;
- (b) Retain the existing requirements for services in-kind, which permits, but does not require recognition of services in-kind; or
- (c) Distinguish services that an entity would have purchased if they had not been donated and services that an entity would not have purchased if they had not been donated and require an entity only to recognize services that would have been purchased.

Please explain your reasons.

#### IPSASB Matter for Consideration 5

Does the IPSASB wish to express a preliminary view on any of the above issues?

- 4.69 The table below summarizes the applicability and manner of applicability of the Exchange/Non-Exchange Approach to a number of common public sector arrangements.

*Table 3, Applying the Exchange/Non-Exchange Approach Public Sector Arrangements*

| Arrangements             | Applicability  |
|--------------------------|--|
| One Year Specific Grants | Applicable. Accounting treatment dependent upon the existence of stipulations and whether those stipulations are conditions or restrictions. |

<sup>13</sup> AASB Fatal Flaw Review Drafts, (AASB 10X), *Income of Not-for-Profit Entities*



|                               |  |
|-------------------------------|--|
| Capital Grants                | Applicable, although distinguishing conditions and restrictions in capital grants may be problematic   |
| Multi-Year Research Grants    | Applicable. Accounting treatment dependent upon the existence of stipulations and whether those stipulations are conditions or restrictions. |
| General (non-specific grants) | Not a Category B transaction. Would be dealt with under revised IPSAS 23 (or IPSAS incorporating IPSAS 23 principles).                       |

#### Advantages of the PSPOA for revenue transactions

- 4.70 The main advantage of the PSPOA is that it removes the need to make judgements about whether revenue and expense transactions are exchange or non-exchange in character. As indicated in Chapter 1, the analysis of whether a transaction is exchange or non-exchange has proved challenging for many preparers. It might be possible to make limited changes to the definition; for example giving some guidance on what “approximately equal value in exchange” means. However, providing further guidance is not straightforward without creating a voluminous rules-based list of transactions, which is unlikely to be exhaustive and may simply lead to different interpretation issues. Under this view identifying whether a transaction contains a performance obligation(s) will frequently be more straightforward than determining whether a transaction is exchange or non-exchange in character.
- 4.71 The PSPOA provides an appropriate basis for accounting for public sector arrangements which are enforceable and require the satisfaction of performance obligations. Under this approach, revenue will be recognized in the accounting period in which the performance obligations are satisfied. The PSPOA supports the objective of faithful representation of an entity’s financial performance by recognizing revenue when earned. The PSPOA also supports the presentation of information that allows users to assess the financial effectiveness and efficiency in which a public sector entity satisfies its performance obligations for the benefit of the public.

#### Disadvantages of the public sector performance obligation approach for revenue transactions

- 4.72 The exchange/non exchange classification of revenue and expense transactions is fundamental to IPSASB’s literature and is familiar to preparers and users of public sector financial statements. While there may on occasions be categorization difficulties, adopting a performance obligation approach may replace one set of interpretation challenges with another—for example, what are distinct goods and services? While it will be clear in many cases whether enforceable arrangements contain performance obligations there will be cases where preparers have to make judgments about whether there are implied performance obligations in arrangements. These judgments may be no more straightforward than determining whether an arrangement is exchange or non-exchange in character. As previously indicated while the exchange/non-exchange distinction has been problematic it is not conceptually deficient.
- 4.73 As indicated in this chapter the PSPOA of itself will not resolve the implementation issues of time requirements or capital grants. For some introducing a new approach which does not address the implementation issues in IPSAS 23 does not justify the costs of change.

- 4.74 Both the PSPOA and the Exchange/Non-exchange approach provide methods of determining when a resource recipient has a liability related to a receipt of resources. Both have requirements on how resources are returned to the resource provider by the resource recipient in the case of non-satisfaction of a performance obligation (PSPOA) or breach of a condition (Exchange/Non-Exchange Approach). While this CP has suggested that there might be greater flexibility in the interpretation of enforceability in a public sector context (see paragraph 4.8) it seems unlikely that accounting outcomes will differ significantly dependent on which approach is adopted.
- 4.75 While extensively modified from IFRS 15 to reflect public sector circumstances the PSPOA is based on a very recent private sector standard. IFRS 15 is not effective until accounting periods commencing on or after 1 January 2018 and therefore it is too early to assess its success. It will take some time for the application of IFRS 15 to be applied to a range of revenue transactions and for consistent interpretations to be established. Consequently it may be some time for any unforeseen outcomes from IFRS 15's application to become apparent. As already noted the IASB has put the effective date back from January 1<sup>st</sup> 2017 to January 1<sup>st</sup> 2018 and in April 2016 issued clarifying amendments. Some argue that developing an approach based on a private sector model that has not had time to 'bed down' is premature.

#### Advantages and disadvantages of the Exchange/Non-Exchange Approach for revenue transactions

- 4.76 The advantages and disadvantages of the Exchange/Non-Exchange Approach are largely the converse of those for the PSPOA identified above. They are listed in point form below:

##### Advantages

- The exchange/non exchange classification of revenue and non-exchange expense transactions is entrenched in IPSASB's literature and is familiar to preparers and users of public sector financial statements.
- Application of the exchange/non-exchange distinction has been problematic, but it is not conceptually deficient.
- Retaining the exchange/non-exchange approach in a modified form will impose lower costs on preparers than the introduction of new approach.
- While there are deficiencies with the exchange/non-exchange approach these are well-known. Introducing a new approach risks new interpretation challenges.

##### Disadvantages

- Determining whether a transaction is exchange or non-exchange can be problematic time-consuming for preparers
- The distinction between exchange and non-exchange is of very limited interest to users.

**IPSASB Matter for Consideration 6**

Does the IPSASB wish to express a preliminary view on whether it supports the Public Sector Performance Obligation approach or retention of the Exchange/Non-exchange approach for dealing with Category B transactions?

**Specific Matter for Comment 7**

Do you favor the Public Sector Performance Obligation Approach or the Exchange/Non-exchange approach for dealing with Category B revenue transactions?

If you support an alternative approach please describe this approach.

Please give your reasons

## 5. Non-Exchange Expenses—Initial recognition

### Introduction

- 5.1 This chapter discusses the initial recognition of non-exchange expenses. It then highlights the transactions that are within scope of this CP [based on the current position on scope and definition of the Social Benefits ED], explains three approaches for initial recognition and evaluates the approaches. Chapter 6 deals with the measurement of non-exchange expenses.

### Non-Exchange Expense Transactions within Scope

- 5.2 Non-exchange expenses include principally:
- (a) Collective goods and services;
  - (b) Other transfers in kind; and
  - (c) Transfers and grants to other entities.
- 5.3 Collective goods and services have the following characteristics:
- (a) They are delivered simultaneously to each member of the community or section of the community;
  - (b) Individuals cannot be excluded from the benefits of collective goods and services;
  - (c) The use of the collective service is usually passive— that is, it does not require the explicit agreement or active participation of individual recipients; and
  - (d) The provision of a collective service to one individual does not reduce the amount of that service available to others—it is not exclusive in nature.
- 5.4 The provision of defense, the conduct of international relations, public order and safety and street lighting are examples of collective goods and services.
- 5.5 Other transfers in kind are goods and services provided to individuals and households other than to protect against a social risk (see below paragraph 5.8). They include universal healthcare and universal education provision (see below).
- 5.6 Transfers to other entities may include detailed conditions and other performance obligations on the part of the recipient, such as specific grants, or may be general transfers to finance the overall activities of an entity. Such general transfers may not include substantive conditions or performance obligations.
- 5.7 Non-Exchange expenses do not include social benefits as developed in IPSASB's separate project on social benefits:
- 5.8 Key to the definition of social benefits is the definition of "social risks". Social benefits protect the entire population, or a particular segment of the population, against certain social risks. Social risks are events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income. In other words, a social risk is an event or circumstance that could adversely affect a household's budget. The term social risk does not cover other risks that would not have an impact on a household's budget. For this reason, certain very significant government expenditures for goods and services provided to individuals and households are not within the definition of social benefits, even though in terms of service delivery they may be very similar to expenditures that are within that definition. For example,

the universal provision of services such as healthcare and education is not within the definition of social benefits, but is clearly a very large expenditure in many jurisdictions.

## The Approaches

5.9 This section explores three approaches to the initial recognition of non-exchange expenses:

- (a) The Expanded IPSAS 19 Approach;
- (b) The Public Sector Performance Obligation Approach; and
- (c) The IPSAS 23 Reverse Approach.

### *The Expanded IPSAS 19 Approach*

5.10 As already noted in Chapter 2, in the absence of an IPSAS specifically addressing non-exchange expense transactions a number of preparers have used IPSAS 19 to determine accounting policies. The IPSAS 19 approach would formalize this practice. It would bring all non-exchange expenses that do not meet the definition of social benefits within the scope of a revised IPSAS 19 by not restricting liabilities to those of uncertain timing or amount.

5.11 Under the Expanded IPSAS 19 Approach the determinant of whether the transferor of resources has an expense and a liability is whether there is an obligating event – that is to say an event that creates a legal obligation or non-legally binding obligation that results in the transferring entity having no realistic alternative to settling that obligation. An obligating event results in a present obligation, and, subject to the satisfaction of recognition criteria, a liability of the transferor.

5.12 The Consultation Paper, *Recognition and Measurement of Social Benefits*, issued by the IPSASB in July 2015 put forward a number of possible points at which an obligating event might occur for programs delivering social benefits:

- (a) Key participatory events have occurred;
- (b) Threshold eligibility criteria have been satisfied;
- (c) The eligibility criteria to receive the next benefit have been satisfied;
- (d) A claim has been approved; and
- (e) A claim is enforceable.

5.13 Many of these possible points are relevant to the broader consideration of non-exchange expenses. A public sector entity may have a number of future obligations relating to the provision of collective goods and services and other transfers in kind. Such obligations are an aspect of the ongoing activities of governments and other public sector entities. However, only present obligations gives rise to liabilities. The IPSASB is of the view that collective goods and services do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of those services to beneficiaries. For a government or other public sector entity to recognize an expense and liability for the provision of collective goods and services in future reporting periods is analogous to a manufacturing entity recognizing an expense and liability for the costs of production in future years. Such an approach would not meet the objectives of financial reporting, because it would not provide information that faithfully represents an entity's financial performance or financial position.

**Preliminary View 3**

The IPSASB is of the view that under the Expanded IPSAS 19 Approach collective goods and services do not give rise to obligating events and therefore expenses or liabilities do not arise prior to the delivery of those services to beneficiaries.

Do you agree with the IPSASB's Preliminary View 3? If not, please give your reasons.

- 5.14 The IPSASB acknowledges that programs delivering other transfers in kind may include eligibility criteria. However, prior to delivery of services the IPSASB thinks it unlikely that the transferor of resources has little or no realistic alternative to avoid settling obligations. Therefore other transfers in kind do not give rise to expenses and liabilities of the transferor prior to the delivery of services.

**Preliminary View 4**

The IPSASB is of the view that under the Expanded IPSAS 19 Approach other transfers in kind do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of services to beneficiaries

Do you agree with the IPSASB's Preliminary View 4? If not, please give your reasons.

- 5.15 The point at which an obligating event occurs for inter-governmental and other transfers to external entities may be the point at which a binding agreement is signed by both parties or a future point identified in a binding agreement that identifies actions which give rise to enforceable rights and obligations. However, jurisdiction-specific factors need to be taken into account. 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 able to be revised or revoked by the transferring entity's governing body, in order to be binding. The requirements related to authorizations and/or appropriations need to be considered on a jurisdictional basis in determining how they affect the timing of an obligating event.

**Advantages of the Expanded IPSAS 19 Approach**

- 5.16 The major advantage of the Expanded IPSAS 19 Approach is that it adopts the same analytical framework that the IPSASB is applying in the ED on social benefits. Because the definition of social benefits that the IPSASB has adopted is linked to the definition of social risks developed and used in statistical accounting the programs providing benefits to those meeting eligibility criteria can be seen as part of a continuum rather than falling within very clearly demarcated categories. Applying different analytical frameworks for programs which have common characteristics runs the risk that very similar transactions will be accounted for differently.
- 5.17 While IPSAS 19 was developed for exchange transactions the Expanded IPSAS 19 Approach has the merit that it was designed to determine when liabilities (and therefore expenses) arise, unlike the other two approaches, which were both derived from models dealing with revenue transactions.

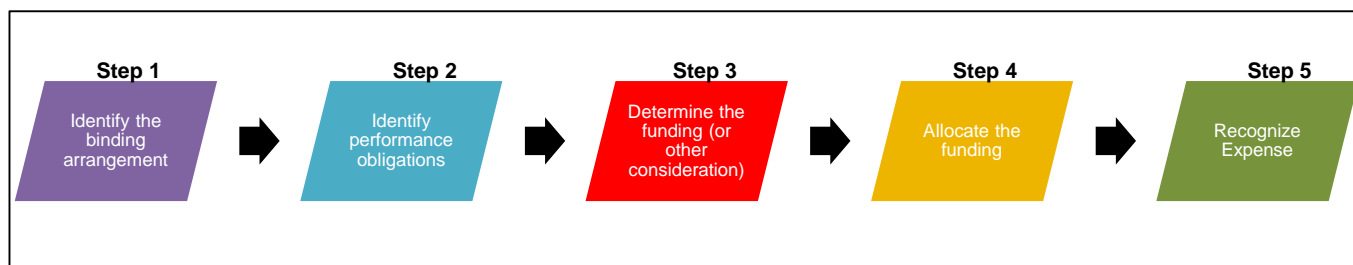
**Disadvantages of the of the expanded IPSAS 19 approach**

- 5.18 The main disadvantages of the expanded IPSAS 19 approach are:
- (a) The approach adopts a framework that was not primarily designed for non-exchange expenses;

- (b) The approach adopts a framework designed for the identification of the provisions of uncertain timing or amount rather than specifically for liabilities where the timing and amount of the expenses is certain;
  - (c) IPSAS 19 reflects definitions and approaches which are arguably out-of-line with up to date conceptual thinking;
  - (d) It is less likely that the timing of recognition of expense and revenue by both parties to an arrangement will coincide than with the other two models; and
  - (e) Modifying IPSAS 19 would reduce alignment with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
- 5.19 The IPSASB acknowledges these points but does not think that they give rise to insuperable difficulties. The obligating event approach drawn from IPSAS 19 was put forward as one of three potential approaches to determining when expenses and liabilities arise in programs to deliver social benefits in the Social Benefits Consultation Paper. While there was considerable variation in the views of respondents as to the point at which obligating events arise, there was overall support for the approach and far more support than for the other approaches discussed – the social contract approach (which the IPSASB has rejected) and the insurance accounting approach (which the IPSASB considers may be appropriate for a small number of programs with the characteristics of insurance arrangements that are intended to be fully funded). Respondents did not highlight any other viable approach in addition to the three identified by the IPSASB in that Consultation Paper.
- 5.20 The IPSASB acknowledges that IPSAS 19 contains recognition criteria that will need to be modified to align with the Conceptual Framework. However, the need to amend the recognition criteria so that uncertainty about the flows of service potential or the ability to generate economic benefits is reflected in measurement estimation has been acknowledged and will be addressed in a separate project. IPSAS 19 also contains definitions of a contingent asset and a contingent liability. The conceptual validity of contingent assets and contingent liabilities has been questioned – in both the public sector and the private sector. However, any misgivings about the continuation of contingent liabilities and contingent assets as defined terms does not invalidate the focus on identification of an obligating event that is the central feature of the Expanded IPSAS 19 Approach.
- 5.21 The Expanded IPSAS 19 approach does not attempt to mirror a revenue recognition approach, so it is less likely to lead to consistency of accounting approach between resource providers and resource recipients. Those who favor resource providers and resource recipients recognizing expense and revenue simultaneously will probably view this as a disadvantage, especially if the two entities are both controlled entities of the same controlling entity.

#### *The Public Sector Performance Obligation Approach*

- 5.22 The PSPOA for non-exchange expenses is the counterpart to that approach for revenue transactions discussed in Chapter 4. The five steps discussed in Chapter 4 have been retained for non-exchange expenses. Step 5 has been modified to reflect the expense context. In essence, the approach to non-exchange expenses involves the transferor of resources recognizing an expense and a liability when the resource recipient satisfies identified performance obligations. As indicated in Chapter 4 the satisfaction of a performance obligation may involve the delivery of services to a resource beneficiary rather than the resource provider, and on occasions do not immediately involve the delivery of services. Where necessary the key characteristics in Chapter 4 have been modified to reflect a resource provider perspective. This section does not repeat all the analysis in Chapter 4.



**Step 1 Identify the binding arrangement.**

5.23 As indicated in Chapter 4, PSPOA includes binding arrangements with performance obligations established through legislation or regulation and is not limited to contracts.

**Step 2 Identify the performance obligations, (which benefit either the resource provider or resource beneficiary)**

5.24 In order for a non-exchange expense transaction to be accounted for under the PSPOA the arrangement must contain performance obligations of the resource recipient. Where the arrangement involves two parties, evaluating whether the resource recipient has satisfied a performance obligation should be relatively straightforward for the resource provider. Tripartite transactions in which a public sector entity (resource provider) provides resources to another entity (resource recipient) that benefits other parties (resource beneficiaries) may present challenges. In such cases resource providers may need to evaluate arrangements between resource recipients and resource beneficiaries so that information is available in order to determine whether the performance obligations of resource recipients have been met.

5.25 The funding arrangement must contain performance obligations of a resource recipient that can 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.

**Step 3. Determine the funding (or other consideration)**

5.26 Consistent with Chapter 4 the PSPOA is applicable to arrangements where the amount of funding is determined by the resource provider based on the level of agreed services to be delivered by the resource provider according to the following principles:

- (a) The amount of expected expense will change as a result of changes to the nature, cost, value or volume of the promised services to be delivered by the resource recipient; and
- (b) The amount of expected expense reflects the amount the resource provider expects to incur for the delivery of those services.

5.27 The total amount of agreed funding will be the amount the resource provider expects to incur in an enforceable arrangement

**Step 4 Allocate the funding to each identifiable and specific performance obligation**

5.28 The resource provider allocates 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 incur as a result of satisfaction of the performance obligations by the resource recipient.

- 5.29 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 an expense in accordance with the guidance for Category A transactions i.e., when the resource provider has a present obligation for the transfer of the resources represented by the donation component. This is the mirror of the approach for a resource recipient discussed in Chapter 4.
- 5.30 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 enforceable arrangement. In such circumstances it can prove difficult to determine the stand-alone selling price of each identifiable and specific performance obligation in the funding arrangement and the arrangement could not be addressed under the PSPOA.

Step 5 Expense is recognized by the resource provider when (or as) the resource recipient satisfies the performance obligation

- 5.31 The trigger for expense recognition for the resource provider is when the recipient satisfies the promised performance obligation. In a transaction involving three parties (resource provider, resource recipient and resource beneficiary), the resource provider recognizes an expense and a liability (or reduction of an asset) when (or as) the resource recipient delivers the promised services to the resource beneficiary. This relies on the resource provider being able to determine that the resource recipient has satisfied the performance obligation. This is likely to be more complex in arrangements where services are provided to resource beneficiaries.
- 5.32 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 a period).

Advantages of the performance obligation approach

5.33 The major advantages of the performance obligation approach are:

- (a) As noted in Chapter 4 the PSPOA does not require an entity to assess whether a transaction is exchange or non-exchange in nature. This responds to the difficulties that preparers have in determining whether a transaction is exchange or non-exchange in character, as identified in Chapter 1.
- (b) The PSPOA may lead to a consistency of accounting approach between resource providers and resource recipients. Because the performance obligations will need to be identified when the funding agreement is entered into by both resource providers and resource recipients and expense/revenue allocated to each performance obligation both resource providers and resource recipients should recognize expense and revenue at the same time and for the same amounts. This will be more easily understandable for users, who may consider that accounting for funding arrangements in which resource providers and resource recipients recognize different amounts at different times is confusing and reflects a lack of accountability that is not in the public interest.
- (c) The PSPOA may lead to improvements in public sector financial management because in order to operate the approach, funding agreements must clearly identify the specific deliverables under funding arrangements and the expense/revenue attached to those deliverables. This will

give an incentive to both resource providers and resource recipients to reduce ambiguities in funding arrangements.

#### Disadvantages of the public sector performance obligation approach

- 5.34 The disadvantages identified with the PSPOA for revenue in Chapter 3 also apply to the modified model for accounting for non-exchange expenses. Some consider that if the consequences of adapting a new recognition model designed for commercial contractual arrangements to non-commercial revenue transactions may be unforeseen, this is likely to be intensified for non-commercial expenses. Like its revenue counterpart, the PSPOA can only be applied to non-exchange expense transactions that include performance obligations. Its adoption will therefore still leave a 'literature gap' for non-exchange expense transactions with no performance obligations. Such transactions will have to be addressed elsewhere—probably in a variant of IPSAS 19—in order to determine when a resource provider has a present obligation.
- 5.35 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 identified in the enforceable arrangement. In such circumstances it can prove difficult to determine the stand-alone selling price of each identifiable and specific performance obligation within the funding arrangement. Consequently the PSPOA is not appropriate for all transactions with performance obligations.
- 5.36 The approach depends on regular and robust information flows between resource provider and resource recipient. If information flows are irregular and incomplete the approach is unlikely to lead to a consistency of accounting between resource providers and resource beneficiaries and will therefore not provide faithfully representative and relevant information.
- 5.37 The model may lead to inconsistencies with the approach being developed for accounting for social benefits. This risk may not be great, as obligating events of resource providers in the Expanded IPSAS 19 Approach may coincide with the satisfaction of performance obligations by resource recipients. However, there is a risk that very similar transactions from similar programs might be accounted for differently.
- 5.38 The PSPOA does not address the large number of transactions that do not contain performance obligations. These transactions would have to be addressed through either the Expanded IPSAS 19 approach or the IPSAS 23 Reverse Approach.

#### *The IPSAS 23 Reverse Approach*

- 5.39 The IPSAS 23 Reverse Approach shares similarities with the PSPOA in that both are revenue recognition models that are modified in order to provide requirements and guidance for resource providers on the timing of expense recognition. Under the IPSAS 23 Reverse Approach the transferor of resources determines whether a funding arrangement contains stipulations, and if so, whether those stipulations are conditions or restrictions. The approach would reflect revisions arising from resolution of the implementation issues considered in Chapter 4.
- 5.40 In the case of very straightforward funding arrangements where there are no stipulations, the transferor of resources will recognize an expense (and dependent on the timing of the transfer of resources) a payable. Where there are stipulations the transferor will determine whether these stipulations are conditions or restrictions—see discussion in Chapter 2. Because conditions are often synonymous with performance obligations, and assuming that resource providers and resource recipients have equivalent information, accounting outcomes are likely to be similar to the PSPOA

for transactions with conditions/performance obligations. If an agreement contains only restrictions the provider will recognize an expense for the entire amount of the funding when the agreement becomes binding, because in the event of a breach of a restriction by the recipient the provider has no enforceable right to recover the resources. As discussed in Chapter 2 where there are breaches of restrictions, the transferor may have the option of seeking a penalty against the recipient by legal or administrative processes and such actions may result in a direction that the entity fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. However, as explained in IPSAS 23 such a remedy is the result of the recipient breaching the restriction and is not attached to the transferred resource itself. It is therefore treated as a separate transaction.

- 5.41 If the arrangement contains conditions the resource provider will continue to have an asset until the condition is satisfied by the recipient. This is because in the event of the recipient breaching the condition the provider will have an enforceable right to require the recipient to return the resources and therefore will control those resources until the condition is fulfilled. In many arrangements there will be a number of conditions, so the resource provider will have to determine the amount of the funding that relates to satisfaction of a particular condition, so that a faithfully representative portion of the funding may be recognized as an expense.

#### Advantages of the IPSAS 23 Reverse Approach

- 5.42 The main advantages of the IPSAS 23 Reverse Approach are that:

- (a) The approach uses a template that, despite the implementation issues with IPSAS 23 discussed in Chapter 4, is more mature than performance obligation models and has been applied relatively successfully to public sector transactions;
- (b) Like the PSPOA it potentially leads to consistency of accounting by resource providers and resource recipients; and
- (c) It is more versatile than the PSPOA and can deal with expense recognition for transactions that do not contain performance obligations. Therefore it is capable of dealing with both Category A and Category B transactions. Where transactions with performance obligations include a donation component both expenses will be accounted for in the accordance with the same standard. This will mean that preparers do not have to look to two sources of requirements and guidance when dealing with the same transaction.

#### Disadvantages of the public sector performance obligation approach

- 5.43 Despite certain similarities, unlike the PSPOA the IPSAS 23 Reverse Approach requires the preparer to determine whether a transaction is exchange or non-exchange in character. It therefore does not address the implementation difficulties on classification highlighted in Chapter 1.
- 5.44 Although the model has been applied to non-exchange revenue transactions for a number of years, it was not designed for expense transactions. Unforeseen consequences may arise—just as with the application of the PSPOA to expenses.
- 5.45 In reality, interpreting whether a stipulation is a condition or a restriction may not result in the same conclusions by resource providers and resource recipients. This risks increases when there incomplete information or when there is information asymmetry.
- 5.46 The approach also is subject to the same areas that have given rise to implementation difficulties in IPSAS 23 from a revenue perspective and that have been considered in Chapter 4. For example just

as resource recipients have had implementation difficulties with time requirements, resource providers argue that showing a “day one” expense for multi-year general grants does not provide a faithfully representative reflection of financial performance or financial position and does not provide relevant, understandable or comparable information.

**IPSASB Matter for Consideration 7**

Does the IPSASB wish to provide a Preliminary View? If so which approach does the IPSASB favor?

**Specific Matters for Comment 8**

Which, if any, of the three models discussed in this chapter do you support:

- (a) Expanded IPSAS 19 Model;
- (b) The Public Sector Performance Obligation approach; or
- (c) The IPSAS 23 Reverse Approach?

Please explain the reasons for your views. If you do not support any of the three approaches please provide details of the approach that you favor.

## 6. Measurement

### Introduction

- 6.1 Chapters 4 and 5 have addressed recognition issues associated with revenue and non-exchange expenses. The purpose of this chapter is to discuss measurement at initial recognition and subsequent measurement of non-contractual receivables and non-contractual payables.

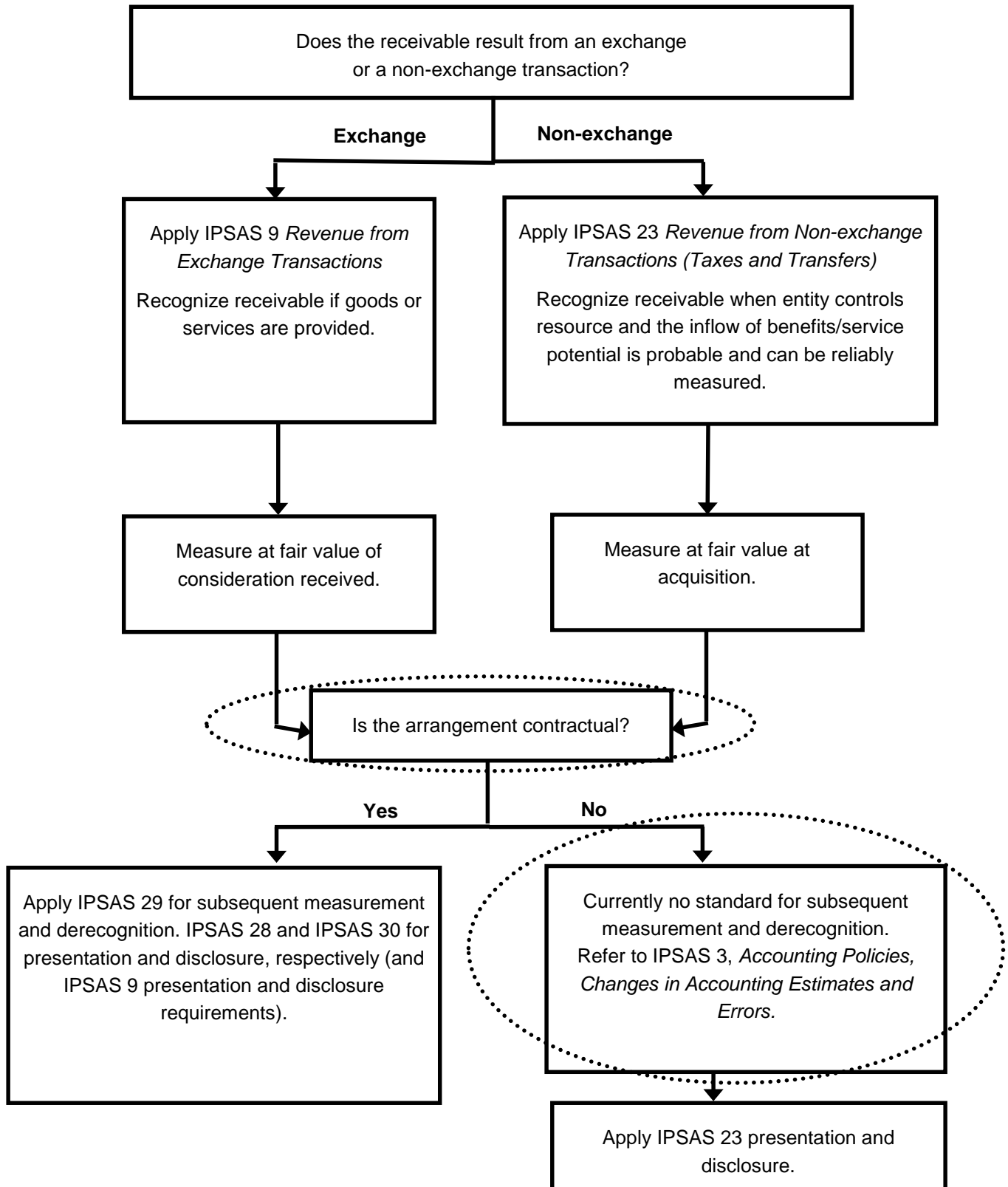
### Non-Contractual Receivables

- 6.2 Non-contractual receivables may take several forms. The most common in the public sector are statutory receivables. Donations, and bequests although less common in the public sector than in the private no-for-profit sector, are other non-contractual receivables.
- 6.3 Statutory receivables are receivables that arise from legislation, supporting regulations or similar mechanisms and require settlement in cash or another financial asset. Because of this settlement requirement they have some, but not all, of the features of financial instruments as defined in IPSAS 28, *Financial Instruments: Presentation*. However, as the terminology indicates they are non-contractual in nature. In addition many transactions do not involve willing parties.
- 6.4 The principal examples of statutory receivables are:
- (a) Taxes;
  - (b) Government transfers;
  - (c) Fines and penalties;
  - (d) Fees; and
  - (e) Licenses.

### *Current position and potential approaches*

- 6.5 The decision tree in Diagram One provides an overview of the initial and subsequent measurement requirements in the current IPSASB literature for both contractual and non-contractual receivables.

Diagram One: Recognition and Measurement of Contractual and Non-Contractual Receivables—Current Literature.



- 6.6 The following paragraphs provide a discussion of this decision tree for non-exchange, non-contractual transactions. This includes providing possible approaches to address the 'gap' that has been identified in the literature for the subsequent measurement of these transactions.

#### Measurement at Initial Recognition

- 6.7 As indicated in Diagram One, requirements and guidance for the measurement at initial recognition of non-contractual receivables which are classified as non-exchange transactions are in IPSAS 23, Non-contractual receivables that are classified as exchange transactions are initially recognized and measured in accordance with IPSAS 9,—these are most likely to be licences and fees. Both IPSAS 9 and IPSAS 23 require initial recognition at fair value.
- 6.8 IPSAS 9.11 defines fair value as “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”.
- 6.9 Some constituents have expressed concern about the appropriateness and interpretation of the fair value requirements in IPSAS 23 for non-contractual receivables. This particularly applies to taxes, fines and penalties.
- 6.10 Although there is no specific standard addressing how to determine fair value<sup>14</sup> IPSAS 29, *Financial Instruments: Recognition and Measurement* does provide guidance on determining fair value for financial assets and financial liabilities. This can be applied to non-contractual receivables by analogy.
- 6.11 IPSAS 29.51 suggests that the best evidence of fair value is quoted prices in an active market. If no active market exists then fair value is established using a valuation technique. This paragraph further states that the objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm’s length exchange motivated by normal operating considerations.
- 6.12 The main issue in the determination of fair value is that there is unlikely to be a market for these transactions, and in the limited circumstances where there is a market, that market is unlikely to be open, active and orderly.
- 6.13 Therefore if there is no active market a valuation technique would need to be applied to determine the transaction price on the measurement date.
- 6.14 Often the transaction price may be set in legislation and/or predetermined, for example fines for breaking traffic legislation. In such cases establishing the transaction price may be relatively straightforward to determine.
- 6.15 Further, depending on the expected timing of the receipt of payment for some non-contractual receivables it may be necessary to consider discounting the transaction price to account for the time value of money. Determining an appropriate discount rate is therefore a further complication. High levels of inflation will need to be taken into account where these are a feature of a jurisdiction’s economy.
- 6.16 To address this issue the IPSASB has identified two options:

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<sup>14</sup> There is no equivalent to IFRS 13 *Fair Value Measurement* in the IPSAS suite of standards. The IPSASB intends to start a project on Public Sector Measurement in 2017.

- (a) The best estimate of the discounted cash flows expected to be received by the entity. Under this approach, non-contractual receivables and revenue are initially recognized at discounted value, with no day one impairment expense for amounts expected to be uncollectible; or
  - (b) The face value of the transaction(s) with the amount expected to be uncollectible recognized as an impairment.
- 6.17 Proponents of option (a) argue that it provides the most realistic and faithfully representative measure of the revenue accruing to the entity. According to this view recognizing revenue for face value amounts, when a large proportion are known to be uncollectible does not provide a faithfully representative measure.
- 6.18 Proponents of option (b) argue that the approach promotes accountability and is in the public interest. Where impairment losses are significant, management and elected officials need to provide explanations. 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 the initial fair value of receivables arising from the exercise of sovereign power should be the amount owed,

#### **Specific Matters for Comment 9**

Do you agree with option:

- (a) Best estimate of the discounted cash flows; or
- (b) Face value of the transaction(s) with the amount expected to be uncollectible recognized as an impairment—for the initial recognition of non-contractual receivables?

Please give your reasons.

#### **IPSASB Matter for Consideration 7**

Does the IPSASB wish to provide a Preliminary View? If so which approach does the IPSASB favor?

#### **Subsequent Measurement**

##### **Current position and proposed potential approaches**

- 6.19 Requirements and guidance on subsequent measurement, derecognition and impairment of non-contractual receivables is not provided in the current IPSASB literature. Therefore, in the absence of a specific standard, some jurisdictions have developed their own policies. Those identified by the IPSASB are (i) applying IPSAS 29, by analogy or (ii) developing accounting policies using the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 6.20 Non-contractual receivables are usually settled in cash therefore, it could be argued that they are very similar to financial assets. IPSAS 28, *Financial Instruments: Presentation*, defines a financial asset in paragraph 9(c)(i) as *a contractual right to receive cash or another financial asset from another entity*.
- 6.21 An argument against using financial instruments standards to develop accounting policies for subsequent measurement is receiving cash or another financial asset from a contractual right is a key feature of a financial asset as defined above and obviously not a feature of non-contractual



receivables. Therefore, some opponents consider that it is not appropriate to apply the financial instrument standards, even by analogy.

- 6.22 Conversely, it may be argued that the existence of a contract is merely part of the form of the transaction and that the substance of the arrangement is akin to a financial asset settled in cash. Therefore it is appropriate to apply the financial instrument principles by analogy.
- 6.23 In accordance with these two views, this section of the Consultation Paper outlines three potential approaches to subsequent measurement. These three approaches were discussed in the South African Accounting Standards Board's 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments*.<sup>15</sup> These approaches have been developed after considering the accounting practices for non-contractual receivables of other jurisdictions.<sup>16</sup>
- 6.24 These approaches are:
- (a) Approach 1 - Fair Value or Market Value Approach;
  - (b) Approach 2 - Amortized Cost Approach; and
  - (c) Approach 3 - Cost Approach.
- 6.25 Approaches 1 and 2 use the principles in the financial instruments standards while approach 3 uses the principles in IPSAS 26, *Impairment of Cash-Generating Assets*.

#### *Approach 1- Fair Value or Market Value Approach*

- 6.26 Under Approach 1 non-contractual receivables are subsequently measured at fair value using the principles in IPSAS 29 by analogy. Under this approach:
- (a) The present value of the cash flows associated with the receivable is determined at each reporting date using a market rate at that date;
  - (b) Any changes in value since the last reporting date are recognized in surplus or deficit; and
  - (c) Derecognition, presentation, and disclosure requirements are drawn from IPSAS 28-30.
- 6.27 The main issue with this approach is the selection of a market rate. As previously indicated there is unlikely to be a market for many of the transactions arising from non-contractual receivables. The position is compounded because the credit risk associated with a large number of counterparties, which is a feature of non-contractual receivables arising from taxes, fines and penalties is difficult to assess.
- 6.28 This means that identifying similar financial instruments with the same terms and risk profile is problematic. Under these circumstances reference to a government bond rate is likely to be the only feasible approach.
- 6.29 Some may question whether an approach with fair value at subsequent measurement is appropriate for relatively straightforward items that are not held for sale or exchange. Going forward this approach would need to be aligned with proposals for updating IPSAS 28-30.<sup>17</sup>

<sup>15</sup> Following consultation the SAASB adopted the cost approach

<sup>16</sup> These jurisdictions include Australia, Canada, New Zealand and United States.

<sup>17</sup> IPSASB currently has a project underway to update IPSAS 28-30 to reflect, as appropriate, IFRS 9, *Financial Instruments*.

*Approach 2—Amortized Cost Approach*

- 6.30 Like Approach 1, Approach 2 would apply principles in IPSASB's literature on financial instruments by analogy. However, under this approach subsequent measurement is at amortized cost, rather than fair value. Under this approach the present value of the cash flows associated with the receivable would be determined using the effective interest method and discounted using the original effective interest rate.
- 6.31 In practice the original effective interest rate is likely to be the market rate available at transaction date, because even if interest is levied it is unlikely to be market-related. Under the Amortized Cost Approach, an entity would assess where there is an indication of impairment, and if such an indication exists, would assess the cash flows to determine if the receivable is impaired.
- 6.32 The main advantage of Approach 2 is that it reflects the accounting at subsequent measurement of loans and receivables in IPSAS 29, which are the non-complex financial instruments that non-contractual receivables most obviously resemble. Approach 2 does not require a fair value remeasurement at each reporting date, which is likely to be very onerous and of questionable practicality. However, Approach 2 shares some of the complexities of Approach 1 in terms of identifying a market rate for the effective interest rate at origination. In addition, assessing the cash flows of receivables at reporting date to determine if any of the receivables are impaired could be onerous.

*Approach 3—Cost approach*

- 6.33 Approach 3 relies on the principles in IPSAS 26. Under this approach subsequent measurement is at the lower of carrying value and recoverable amount. An entity accrues interest only if interest is levied under the terms of the arrangement. As in Approach 2 an entity assesses whether there is an indication that a receivable is impaired. If there is such evidence any impairment loss is calculated as the difference between the estimated future cash flows (discounted if appropriate) and the carrying amount. This approach would apply the disclosure requirements in IPSAS 26.
- 6.34 Approach 3 has the advantage of avoiding what are likely to be potentially arbitrary decisions on market interest rates, although decisions on appropriate interest rates will still have to be made if discounting is required for impairment purposes. Alternatively, the approach could be simplified by using undiscounted cash flows. The disadvantage is that it ignores the fact that receivables are financing transactions and excludes the cost of financing from measurement. Some also argue that treating non-contractual receivables differently to other receivables that they only differ from because they are non-contractual is difficult to justify and that using an impairment standard designed for tangible and intangible assets is counter-intuitive. The rejoinder to this argument is in the section on non-contractual payables (see below).

**Specific Matter for Comment 10**

Which of the three approaches identified in this chapter for the subsequent measurement of non-contractual receivables do you support:

- (a) Fair Value or Market Value approach; or
- (b) Amortized Cost Approach; or
- (c) Cost Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

## Non-Contractual Payables

- 6.35 The description of statutory payables mirrors that of statutory receivables in that they are outflows for transactions that do not arise from contracts, but have many of the features of a financial instrument. Such transactions principally include:
- (a) Taxes payable;
  - (b) Appropriations and grants to recipients;
  - (c) Repayments of grants; and
  - (d) Fines and penalties such as those applied by a regulator.
- 6.36 Social benefits (which are also non-contractual payables) are outside the scope of the Consultation Paper<sup>18</sup>, as are transactions with the characteristics of insurance contracts.

### *Current position and potential approaches*

- 6.37 There are no requirements specific to non-exchange expenses in the current IPSASB literature.
- 6.38 IPSAS 19 requires both measurement at initial recognition and subsequently as "the best estimate of the expenditure required to settle the present obligation at the reporting date."
- 6.39 This section of the Consultation Paper outlines three potential approaches. These three approaches were discussed in the South African Accounting Standards Board's 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments*.

### Approach 1—Best Estimate for Settlement Approach

- 6.40 This approach requires initial and subsequent measurement as the best estimate of the amount required to settle the liability, using discounted cash flows where appropriate. In accordance with the IPSASB's Conceptual Framework the rebuttable presumption is that this is on a cost of fulfillment basis, i.e., the cost that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. There may be very limited occasions where cost of release is the appropriate measure. Cost of release is the amount that a third party would charge to accept the immediate transfer of the liability from the reporting entity. Cost of release will only be relevant when it is both feasible and the most resource efficient approach to settlement of the liability (i.e., when cost of release is lower than cost of fulfillment). The absence of an active market will limit these occasions.
- 6.41 The advantage of this approach is that it is in accordance with the Conceptual Framework, relatively straightforward to apply and produces understandable information. Those who consider that the similarities between non-contractual receivables and contractual receivables can be exaggerated favor it. Those who consider that non-contractual and contractual receivables are similar question why non-contractual receivables are not accounted for in the same way as the financial instruments they resemble.

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<sup>18</sup> The IPSAS has another project on Social Benefits which is why they are excluded from this CP.

## Approach 2– Amortized Cost Approach

6.42 Approach 2 mirrors the amortized cost approach for non-contractual receivables. Initial measurement is at fair value and subsequent measurement at amortized cost using the effective interest rate method. Fair value at initial recognition would likely equate to transaction price, unless evidence exists to the contrary. The effective interest rate would be the market-related interest rate determined at initial recognition. The advantages and disadvantages of this approach mirror those of its counterpart for non-contractual receivables – principally identifying a market rate at the transaction date. Conversely to Approach 1 it is favored by those who consider that statutory receivables and contractual receivables are similar and should therefore be accounted for similarly and opposed by those who consider that the similarities between non-contractual receivables and contractual receivables can be exaggerated, particularly where non-contractual receivables are involuntary transactions.

## Approach 3: Hybrid Approach

6.43 Approach Three adopts a dual approach. If cash flows from non-contractual payables are certain in timing and amount they should be accounted for under Approach Two. If the cash flows are uncertain in timing and amount they should be accounted for under Approach One. The rationale for this approach is that non-contractual payables with cash flows that are certain in timing or amount more closely resemble financial instruments as defined in IPSAS than those with cash flows that are certain in timing or amount.<sup>19</sup>

### Specific Matter for Comment 11

Which of the three approaches identified in this chapter for the subsequent measurement of non-contractual payables do you support:

- (a) Best Estimate for Settlement Approach; or
- (b) Amortized Cost Approach; or
- (c) Hybrid Approach?

If you favor an alternative approach please identify that approach and explain it.

Please give your reasons.

<sup>19</sup> Following consultation the SAASB decided not to further develop requirements for non-contractual payables. Non-contractual payables would be accounted for under GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets*, which is the South African equivalent of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Asset*

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