

Meeting: IPSASB Consultative Advisory Group

Meeting Location: Toronto, Canada

Meeting Date: June 18, 2018

Agenda Item 5

For:

☐ Approval

☒ Discussion

☒ Information

REVENUE

Project summary	<p>The aim of the project is to develop one or more IPSASs covering revenue transactions (exchange and non-exchange) in IPSASs.</p> <p>The scope of this project is to develop new standards-level requirements and guidance on revenue to amend or supersede that currently located in IPSAS 9, <i>Revenue from Exchange Transactions</i>; IPSAS 11, <i>Construction Contracts</i>; and IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i>.</p>	
Meeting objectives	Topic	Agenda Item
Discussion Items	<p>CAG input into:</p> <ul style="list-style-type: none"> • Approach to new Revenue standards • Performance obligations and Capital Grants • Recognition of Voluntary Services 	5.1
Other supporting items	Appendix A: IPSASB Due Process Checklist	5.2
	Appendix B: Link to Other Documents	5.3

Agenda Item

5.1

Background

1. Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses* was issued for comment in August 2017 with comments received by 15 January 2018.
2. This CP addressed issues relating to revenue and non-exchange expenses, however this CAG session will only address revenue.
3. Thirty-nine responses were received and the IPSASB received an overview of these responses at the March 2018 Board meeting.
4. Currently revenue transactions are classified as either exchange or non-exchange. Exchange transactions are accounted for using either IPSAS 9, *Revenue from Exchange Transactions* or IPSAS 11, *Construction Contracts*. Non-exchange transactions are accounted for using IPSAS 23, *Revenue from Non-Exchange Expenses (Taxes and Transfers)*.
5. Prior feedback from constituents indicated that making the exchange/non-exchange distinction can be problematic, therefore the issuance of IFRS 15, *Revenue from Contracts with Customers* provided the impetus for the IPSASB to review the approach for accounting for revenue transactions, which resulted in the CP being issued.
6. IFRS 15 uses a performance obligation approach which, in short requires the recognition of revenue as and when performance obligations in a revenue contract are met, which generally equates to the transfer for goods and/or services to the customer.
7. Drawing upon this performance obligation approach the CP categorized revenue transactions as follows:
 - (a) Category A – transactions without any performance obligation or stipulations¹;
 - (b) Category B – transactions with performance obligations or stipulations but not all the characteristics to meet the criteria required by IFRS 15, *Revenue from Contracts with Customers*; or
 - (c) Category C – transactions that have all the characteristics required to be accounted for under IFRS 15.
8. Preliminary View (PV) 1 expressed the Board's view that Category C transactions should be accounted for using an IPSAS drawn primarily from IFRS 15 (i.e. a converged standard), 74% of respondents either agreed or partially agreed with this view – there were no respondents that disagreed.

¹ IPSAS 23 defines Stipulations on transferred assets as: terms in laws or regulations, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

Stipulations can be either Conditions or Restrictions:

- Condition on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.
- Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.

9. PV 3 gave the Board view that Category B transactions should be accounted for using an approach which expands the IFRS 15 requirements to incorporate public sector specific transactions – this approach is named The Public Sector Performance Obligation Approach (PSPOA). The alternative approach to the PSPOA discussed in the CP was to continue using IPSAS 23 (in an updated form) for Category B transactions. Sixty-three percent of respondents either agreed or partially agreed with applying the PSPOA to Category B transactions, whilst 18% disagreed. The remaining respondents either did not comment or their response was not clear.
10. Regarding Category A transactions, the Board view expressed as PV 2 is that these transactions should be accounted for using an updated IPSAS 23. Eighty-two percent of responses either agreed or partially agreed with this PV, no respondents disagreed.
11. Staff consider an updated IPSAS 23 would be a residual standard for transactions that were not accounted for using either an IFRS 15 converged standard or a Public Sector Performance Obligation Approach standard.
12. The Board discussed the responses at the March 2018 meeting and agreed to develop a new revenue standard based on IFRS 15 for Category C transactions and to update IPSAS 23 to address Category A transactions.
13. Before deciding to progress with the PSPOA for Category B transactions the IPSASB directed staff to develop examples to test how an extended IFRS 15 performance obligation approach (the PSPOA) would work for Category B public sector specific transactions.

Approach to new Revenue standards

14. Given the directions from the Board (as noted above) proposed standards for each categorization of revenue transactions at this point are:
 - (a) Category C – Based on IFRS 15 – Performance Obligation;
 - (b) Category B – potentially a PSPOA (expanded IFRS 15) – Performance Obligation; and
 - (c) Category A – Updated IPSAS 23 (residual standard) – not yet decided.
15. As noted above at paragraph 9 the IPSASB favored adopting the PSPOA for Category B transactions. Briefly, the PSPOA is based on the five-step approach in IFRS 15 but these steps will be adapted for use in the public sector. The five steps are:

Step 1 – Identify the Binding Arrangement

Step 2 – Identify the Performance Obligation(s)

Step 3 – Determine the Consideration

Step 4 – Allocate the Consideration

Step 5 – Recognize Revenue.

The critical steps in this approach are Steps 1 and 2 in that if there is no binding arrangement (enforceability in a PSPOA will be expanded beyond just legal enforceability to take into account public sector specific arrangements) or if there are no distinct and identifiable performance obligations on the resource recipient (i.e. is it actually specified (either in the agreement or a mutual understanding) what they are required to do with the resources), then the PSPOA will not be suitable for that transaction and an updated IPSAS 23 would be the appropriate standard to apply.

16. Respondents in favor of adopting PSPOA for Category B transactions commented that adopting a performance obligation approach:

- (a) Could result in fewer scope debates and more meaningful revenue discussions; and
- (b) Would resolve the issues of ambiguity in making the exchange/non-exchange determination.

Therefore adopting a performance obligation approach for revenue transactions would address one of the key issues and difficulties currently faced in applying the current IPSAS 23.

17. In contrast, respondents that disagreed with adopting a PSPOA approach for Category B transactions commented that:

- (a) Category B transactions can continue to be classified as exchange or non-exchange but maybe supplementing the definition with 'with performance' or 'without performance' would make the distinction clearer; and
- (b) Non-exchange transactions are unique to the public sector and should be treated consistently (i.e. Category A and B transactions as well as transactions related to social benefits).

18. Regarding the comment made at paragraph 17(a), staff consider that retaining the exchange/non-exchange distinction and then supplemented by with performance/without performance would create and unwieldy mix of classifications as it would result in three categories:

- (a) Exchange, with performance;
- (b) Non-exchange, with performance; and
- (c) Non-exchange, without performance.

19. However staff acknowledge that the concept of exchange/non-exchange is an important characteristic in the public sector and a key part of the IPSASB Conceptual Framework and current IPSAS literature. However, staff questions if exchange/non-exchange is useful for determining the classification and accounting treatment of revenue.

20. Adopting a performance/no performance obligation approach looks at the substance of a transaction rather than the form, that is, how it is classified. The Conceptual Framework explains that 'Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance - which is not necessarily always the same as its legal form'. Therefore substance over form remains a key quality that information included in GPFRs must possess.

21. Staff are aware that pre-financing² is a particularly significant issue within the European Union as there is uncertainty as to when control of the resources transfers from the resource provider to the resource recipient. Staff consider that a performance obligation approach may help focus both entities on whether or not the agreement includes specifics as to how the resources are to be used and thus provide an indication of when control of the funds passes from the provider to the recipient.

² Pre-financing is a payment intended to provide the beneficiary with a float. It may be split into a number of payments in accordance with the provisions of the underlying contract, decision, agreement or the basic legal act. The float or advance is either used for the purpose for which it was provided during the period defined in the agreement or it is repaid.

22. Based on the comments received to the CP, staff are of the view that a performance obligation/no performance obligation distinction may be easier to apply than the current exchange/non-exchange approach because identifying whether an arrangement has a performance obligation should be easier than determining whether the value of the transaction is of 'approximately equal value' which is the requirement for an exchange transaction. However, staff are aware that appropriate application guidance and illustrative examples will need to be developed and included in any new IPSAS to aid preparers in making this performance obligation/no performance obligation distinction.
23. Further, given that the IPSASB has already decided to proceed with a performance obligation approach for Category C transactions, adopting an expanded, similar approach should lead to consistency for revenue transactions.

Question for the CAG

Does the CAG agree that it is in the Public Interest to proceed with a PSPOA (i.e. a performance obligation approach) for Category B transactions?

Performance obligations and Capital Grants

24. As noted, staff are expanding the five step approach used in IFRS 15 for use in the public sector. One aspect of this will be to consider whether the concept of a performance obligation requires expanding to account for more than just the transfer of good and services (explained below).
25. A performance obligation is defined in IFRS 15 as:

A promise in a contract with a customer to transfer to the customer either:
 - (a) a good or service (or a bundle of goods or services) that is distinct; or
 - (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
26. The objective of identifying each distinct good and service in a contract is to determine when that good or service has been transferred to the customer so that revenue can be recognized as and when each distinct good or service is transferred.
27. However, in the public sector for some transactions there may not be an actual 'transfer' of goods and/or services – for example with capital grants, funding may be provided to develop an asset but there is no actual transfer of this asset to the customer.
28. The current revenue standard, IPSAS 23 does not provide any guidance on how to account for capital grants and this has been raised as an application issue in the CP. The CP did not provide any proposals as to how capital grant should be accounted for – that is whether it should be under a PSPOA or addressed in an updated IPSAS 23. Rather the CP asked respondents to comment on:
 - (a) Whether guidance should be provided on accounting for capital grants; and
 - (b) What methods the IPSASB should consider for accounting for capital grants.
29. In response to the first question 79% of respondents agreed that guidance should be provided. Regarding the second question there were a variety of suggestions including:
 - (a) Using an equivalent to IAS 20, *Government Grants and Disclosure of Government Assistance*;

- (b) Consider the capital grant requirements and guidance developed by the Australian Accounting Standards Board (AASB);
 - (c) Considering the accounting treatment for grants based in the IFRS for SMEs; and
 - (d) Broadening the definition of a performance obligation so that capital grants could be accounted for under the PSPOA.
30. Regarding using an equivalent to IAS 20, it is widely acknowledged that this standard is conceptually flawed therefore this option is not considered viable.
31. The Australian Accounting Standards Board (AASB) expanded the requirements in IFRS 15 for use by not-for-profit entities by including an integral appendix – *Australian implementation guidance for not-for-profit entities* to AASB 15, *Revenue from Contracts with Customers* (which is an equivalent standard to IFRS 15). However, they have retained the concept of transfer of goods and services. This retention of the concept of a ‘transfer’ has resulted in an exception being provided for capital grants whereby they are accounted for by analogy to the performance obligation approach.
32. Considering the approach taken for accounting for capital grants within IFRS for SMEs does have some appeal as it utilizes a performance condition approach, albeit in a very simplified form.
33. Currently staff are exploring whether the definition of a performance obligation could or should³ be expanded so that capital grants could be accounted for under the PSPOA. An expanded definition may include the satisfaction of a requirement and not necessarily be dependent on the transfer of goods or services to qualify as a performance obligation. This may be similar the explanation of a present obligation in IPSAS 23 which is a duty to act or perform in a certain way.
34. If the definition of a performance obligation is expanded to generally go beyond a transfer of goods and services then it would result in consistent accounting for all grants that include specificity as to the deliverables in an agreement.
35. If this definition is not expanded in general, then staff are of the view that the options for accounting for capital grants would be:
- (a) Include an exception in the PSPOA to account for capital grants by analogy (the AASB approach);
 - (b) To include capital grants as a scope inclusion into the definition of a performance obligation; or
 - (c) Addressed under an updated IPSAS 23 which may not resolve the current application issues as it is likely revenue would then be recognized when the grant is receivable by the resource recipient (immediate recognition).
36. Therefore, staff would welcome CAG views on whether the definition of a performance obligation should be expanded beyond the direct transfer of goods and/or services to the provider of a grant or a third party beneficiary.

³ It should be noted that the Conceptual Framework at paragraph BC5.26 states that ‘A performance obligation is an obligation in a contract or other binding arrangement between an entity and an external party to transfer a resource to that other party’.

Question for the CAG

Some grants (e.g. capital grants) may not result in a direct 'transfer of goods and services' and would therefore be outside the scope of a PSPOA based on the present definition of a performance obligation. Therefore, is it in the public interest to expand the definition of performance obligation to go beyond just a direct transfer of goods and services so that these grants could be accounted for under a PSPOA?

Recognition of Voluntary Services

37. The CP also addressed an issue raised by constituents of accounting for services in-kind. Services in-kind are described as 'services provided by individuals to public sector entities in a non-exchange transaction'. These services meet the definition of an asset because the entity controls a resource from which service potential of economic benefits are expected to flow to the entity.
38. Currently IPSAS 23 permits but does not require the recognition of services in-kind so the CP included a Specific Matter for Comment (SMC) with three options to gauge respondents views on this issue. The three options put forward in the SMC were:
 - (a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or
 - (b) Modify requirements to require service in-kind that meet the definition of an asset to be recognized in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or
 - (c) An alternative approach.
39. Responses to the CP did not provide the Board with a clear direction on how to proceed with accounting for services in-kind. Eighteen percent of respondents preferred Option (a), 32% preferred Option (b), 24% suggested an alternative approach, 5% of responses were not clear and 21% of respondents did not comment.
40. Comments made by respondents that preferred Option (a) (retaining the existing requirements) were as follows:
 - (a) The cost of obtaining information on the value of services in-kind received would outweigh the benefits received from reporting this information;
 - (b) Mandating recognition of services in-kind will require entities to establish systems and process to gather auditable information;
 - (c) The IPSASB could look at mandating disclosure on the nature and type of major classes of services in-kind received (rather than just encouraging) – this will improve financial reporting in this area;
 - (d) Because services in-kind are recognized and consumed immediately there is no impact on surplus or deficit and the statement of financial position on a net basis, therefore the argument regarding comparability may be minimal;
 - (e) There is difficulty in obtaining a reliable measurement, and even if only those services that would have been purchases are accounted for, judgement is needed to determine which types of services these are therefore the issue regarding comparability is not resolved;

- (f) There may be difficulty in determining whether an entity has control (over an individual) for accounting purposes;
 - (g) Before mandating the recognition of services in-kind the IPSASB needs to provide more evidence of its usage across government jurisdictions and the need for further guidance in this area; and
 - (h) Services in-kind are important for some international organisations (i.e. Aid agencies, UN) but not so much other entities.
41. Of the respondents that favored Option (b) (modify the existing requirements), the following comments were made:
- (a) Services in-kind can make up a significant portion of some entity's operating activity, not requiring measurement of this could considerably understate the size of the organizations operations and its significant to the economy for all stakeholders and decision makers;
 - (b) Agree there may be measurement difficulties but recognizing only those services that can be measured in a way that meets the necessary requirements for reporting would result in useful information;
 - (c) Where services in-kind received do not meet the necessary criteria, the IPSASB could mandate disclosure about the nature and type of services received;
 - (d) Recognition of services in-kind received should be mandated for reasons of comparability and transparency;
 - (e) The materiality or significance of the services to the entity's operations must be considered;
 - (f) Recognition of services in-kind that enhance service delivery capacity is useful for accountability and decision-making purposes; and
 - (g) Agree that if the services in-kind would have been purchase they should be recognized.
42. Alternative approaches suggested by respondents in Option (c) included:
- (a) Services in-kind should be recognized if they meet the requirements in Option (b) and if obtaining the information is cost effective;
 - (b) Suggest only recognizing services in-kind delivered by traders or professionals, we note that the existing requirements are rarely applied in practice which might be a result of the practical difficulties in generating reliable information or the limited informational value of the information, this option may be a more practical accounting approach;
 - (c) User needs would be better met by disclosure of non-financial information. Increased transparency as to how reliant on volunteer services the public sector is would better facilitate policy decisions. This is particularly so for those entities where without volunteers governments may need to step in (e.g. ambulance, fire);
 - (d) Prescribing an alternative to record services in-kind at nominal value (symbolic value) of currency unity with detailed disclosures;
 - (e) Services in-kind are free and should not be accounted for in the general ledger therefore documented, explained and disclosed off balance sheet; and
 - (f) IPSASB should develop more specific guidance for the recognition and measurement of services in-kind.

43. At the March IPSASB meeting the Board directed staff to reexamine respondent comment letters especially those where the response was not clear with the intention that the issue be discussed at a future meeting.
44. At indicated above, there are many views on how services in-kind should be accounted for but staff consider that the key issues that should be considered are:
 - (a) Cost/benefit of providing the information;
 - (b) Usefulness of the information for accountability and decision making purposes;
 - (c) Significance to the entity;
 - (d) Potential loss of information if not provided;
 - (e) Transparency and comparability;
 - (f) Difficulties in measurement; and
 - (g) Difficulty in assessing whether an entity has control.

Question for the CAG

Does the CAG have any views on which approach best meets the public interest?

Agenda Item 5.2

Appendix A: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)

Project: Revenue

#	Due Process Requirement	Yes/No	Comments
A. Project Brief			
A1.	A proposal for the project (project brief) has been prepared, that highlights key issues the project seeks to address.	Yes	The IPSASB considered the project brief at its March 2015 meeting (see Agenda Item 10).
A2.	The IPSASB has approved the project in a public meeting.	Yes	See the minutes of the March 2015 IPSASB meeting (section 10) .
A3.	The IPSASB CAG has been consulted on the project brief.	N/A	<ul style="list-style-type: none"> This step is not in effect for this project.
B. Development of Proposed International Standard			
B1.	The IPSASB has considered whether to issue a consultation paper, or undertake other outreach activities to solicit views on matters under consideration from constituents.	Yes	The IPSASB issued Consultation Paper, <i>Accounting for Revenue and Non-Exchange Expenses</i> in August 2017.
B2.	If comments have been received through a consultation paper or other public forum, they have been considered in the same manner as comments received on an exposure draft.	N/A	Yes, the IPSASB received feedback on responses to the consultation paper at the March 2018 meeting.
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.	Yes	This Agenda Item seeks the CAG's views on the significant issues to be address in the development of the exposure draft.
D. Consideration of Respondents' Comments on an Exposure Draft			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the exposure draft and the IPSASB's related responses.	N/A	
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the	N/A	

#	Due Process Requirement	Yes/No	Comments
	IPSASB's attention. Staff have reported back to the IPSASB CAG the results of the IPSASB's deliberations on those comments received from the CAG.		

Appendix B: Links to Other Documents

45. This appendix provides links to document which may be useful to CAG members in providing a background related to the project.
- (a) Revenue project page
 - (b) [Consultation Paper, Accounting for Revenue and Non-Exchange Expenses](#)
 - (c) [IPSASB Work Plan – March 2018](#)