

**Meeting:** IPSASB Consultative Advisory Group  
**Meeting Location:** Toronto, Canada  
**Meeting Date:** June 17, 2019

# Agenda Item 5

For:  
☐ Approval  
☒ Discussion  
☒ Information

## REVENUE - CAPITAL GRANTS

<b>Project summary</b>	<p>The aim of the project is to develop one or more IPSAS covering revenue transactions (exchange and non-exchange) in IPSAS.</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>	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Discussion Items</b>	<p>CAG input into:</p> <ul style="list-style-type: none"> <li>Issue: If Capital Grants are in Scope of ED 71, what Accounting Treatment is Appropriate?</li> </ul>	5.1
<b>Other supporting items</b>	<a href="#">Appendix A: Reference Examples</a>	5.2
	<a href="#">Appendix B: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)</a>	5.3
	<a href="#">Appendix C: Links to Other Documents</a>	5.4

## Background

1. In IPSAS, revenue transactions are currently accounted for based on their classification 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)*.
2. The IASB's issuance of IFRS 15, *Revenue from Contracts with Customers* provided the impetus for the IPSASB to initiate a project to review the accounting for revenue transactions. The first output of the revenue project was the Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses*. The responses received to that CP highlighted a need for guidance on accounting for capital grants (79% of respondents cited a need for guidance on accounting for capital grants).
3. IPSAS 23 currently does not define capital grants, and the IPSASB will need to determine if a formal definition should be developed. For the purposes of this paper, the working definition of a capital grant is, "a transaction in which one entity (the grantor) provides an asset, or cash with a requirement that the recipient acquire or construct an asset, without receiving from the recipient any good, service, or asset in return as a direct counterpart."
4. It may be possible for a grant to require the recipient to construct an asset then subsequently use the asset for a specific purpose over a specified period of time—e.g., construct a building then operate it as a school for 20 years. In such arrangements, the grant contains two components: a capital grant with the requirement to construct the building and an operating grant with the requirement to operate the building as a school for 20 years. This paper addresses the capital grant component, because the IPSASB will consider operating grants separately.
5. This paper sets out alternatives on accounting for capital grants **from the recipient's perspective**, i.e. how should a recipient recognize the credit entry on receipt of a capital grant.

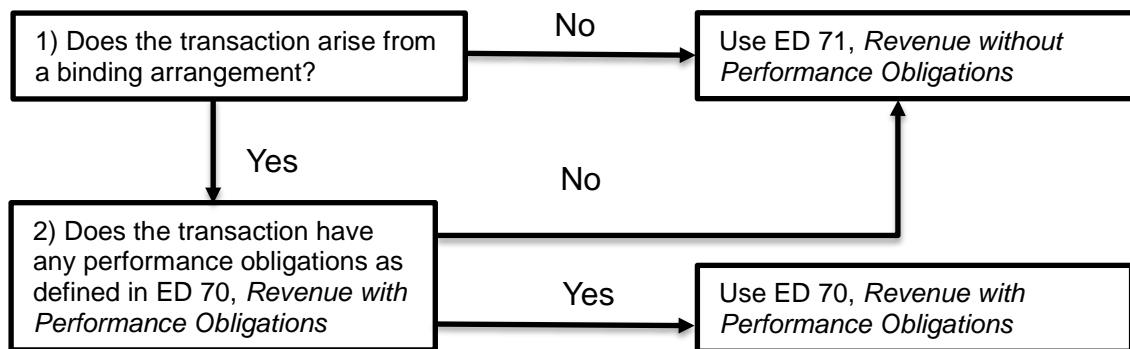
## Summary of Decisions Made to Date

6. The IPSASB decided in June 2018 that capital grants do not meet the definition of a performance obligation, as defined in the revenue project developing Exposure Draft 70, *Revenue with Performance Obligations* (ED 70), because there is no transfer of a good or service to either the purchaser or a third-party beneficiary.
7. A fundamental aspect of the revenue recognition model in ED 70 is that revenue is only recognized once control over the goods or services provided by an entity has passed to the purchaser or a third-party beneficiary. Since a performance obligation represents the unit of account in which revenue is recognized, the *transfer* of goods or services is required to properly reflect the timing of when the purchaser or third-party beneficiary has obtained control of these goods or services.
8. The IPSASB decided in December 2018 that transactions that are not enforceable, but which have intentions or expectations by resource providers in the period(s) in which they are to be used are to

be recognized when the consideration is receivable<sup>1</sup>, and that the intentions or expectations of the resource provider are to be communicated via enhanced display or disclosure.

9. In March 2019 the IPSASB:
- (a) Instructed staff to consider if there are any enforceable transactions which have obligations that are not “performance obligations” as defined in ED 70 and provide possible accounting options.
  - (b) Decided that ED 70 should be titled *Revenue with Performance Obligations* and that the Exposure Draft for IPSAS 23 transactions should be called Exposure Draft 71, *Revenue without Performance Obligations* (ED 71).
  - (c) Decided that the flowchart—Diagram 1, should be used to determine whether a revenue transaction is in the scope of ED 70 or ED 71.

Diagram 1



10. Diagram 1 indicates that the determination of whether a transaction is within the scope of the ED 71 follows a two-step process:
- (a) The first step considers if the transaction arises from a binding arrangement. If the arrangement is not binding, the transaction is within the scope of ED 71.
  - (b) If there is a binding arrangement, the next assessment is to consider if it has any performance obligations as defined in ED 70. If there are no performance obligations, the transaction is within the scope of ED 71.
11. If a capital grant arises from a non-binding arrangement, the transaction results in immediate revenue recognition because there is nothing further required by the recipient and the grantor has no recourse. Therefore, the analysis that follows focuses on enforceable arrangements only.

<sup>1</sup> For example, an entity qualifies for a grant of CU300 to be paid in 3 separate payments—CU100 upon signing of the grant agreement, and CU100 on each of the 1st and 2nd anniversaries. If the grant arrangement was not enforceable, the entity would recognize the transaction as follows: CR grant revenue of CU300 at the transaction date, DR cash of CU100 for the amount received upon signing and DR receivable of CU200. The receivable would be drawn down as cash is received on the 1<sup>st</sup> and 2<sup>nd</sup> anniversaries.

12. Step two in Diagram 1 requires an assessment of whether the grant includes performance obligations, as defined in ED 70.
13. A performance obligation is defined in paragraph 9 of ED 70 as:  
“... a promise in a binding arrangement with a purchaser<sup>2</sup> to transfer to the purchaser or third-party beneficiary either:
  - (a) A good or service (or a bundle of goods or services) that is separately identifiable; or
  - (b) A series of separately identifiable goods or services that are substantially the same and that have the same pattern of transfer to the purchaser.”
14. Capital grant transactions do not meet the definition of a performance obligation because there is no transfer of any good, service or asset to the purchaser or a third-party beneficiary. Therefore, capital grants will be dealt with in ED 71.

**Issue: If Capital Grants are in Scope of ED 71, what Accounting Treatment is Appropriate?**

15. Upon the receipt of a capital grant, a recipient would record the resources received as an asset in the financial statements.<sup>3</sup> The issue is how should the recipient record the credit entry in the transaction. The possible options are:
  - (a) Option 1 – Immediate recognition, i.e., record the credit as revenue upon receipt;
  - (b) Option 2 – Recognition over the construction period (or period prior to the asset becoming operational) on a straight-line or other systematic basis, such as stage of completion; or
  - (c) Option 3 – Recognition in accordance with obligations in the binding arrangement where non-performance can require a return of resources (analogous to performance obligation approach).

*Option 1 – Immediate Recognition*

16. The IPSASB decided that revenue transactions that are not enforceable should be recognized immediately, with donor intentions or expectations communicated in the financial statements through enhanced display or disclosure.
17. Some may argue that the terms of a capital grant, that do not meet the definition of performance obligation in ED 70, also are not obligations which give rise to a liability. Those who support this view argue that even if the terms of the grant specify the return of resources if the grant recipient does not complete construction or acquisition of the asset, the liability related to the return of the funds occurs only after the terms of the arrangement are breached and the purchaser requests the return of funds. Proponents of this option view the grant terms similar to a contingent liability under IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, as a future event (breaching the terms of

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<sup>2</sup> In the context of a capital grant, the grantor is considered the purchaser, as it is the party providing consideration to the grant recipient, who is considered the entity providing the goods or services.

<sup>3</sup> There may be issues surrounding whether the assets or cash received should be presented and/or disclosed as restricted assets or cash. However, this is a presentation and disclosure issue, and the recognition and measurement of the underlying assets received are not expected to change.

the grant) has not yet occurred to give rise to a present obligation. Therefore, rather than recognition, the contingency would be disclosed in the notes to the financial statements.

18. If the terms of the grant do not include performance obligations or any form of obligation, revenue would be recognized immediately as these are essentially the same as unenforceable transactions described in paragraph 13.

*Option 2 – Recognition over the Construction Period*

19. Some argue that capital grants may include terms that give rise to obligations, but not performance obligations, because there is a lack of transfer of goods or services to the grantor or a third-party beneficiary, and lack specificity in the terms of the arrangement.
20. Because the terms of the capital grant are not specific (details of required specific tasks not set out) recognition of revenue would be based on some systematic basis, such as straight-line basis over the construction period or life of the arrangement, or by verifiable milestones during construction such as the stage of completion.
21. This option addresses constituents' concerns about the mismatch between revenue recognition and the consumption of resources. Some may argue that the consumption of resources is a proxy for performance against the non-specific terms of the arrangement.
22. In addition, even with enhanced display or disclosure as required under Option 1, some may argue that disclosure does not provide the same information value compared with presentation within the primary financial statements (particularly the statements of financial position, financial performance, and cash flows). Recognition over the construction period would result in information which highlights the fact that there are terms (e.g., constructing a building) which the recipient is required to meet to satisfy.
23. For example, the terms of a capital grant may include a general requirement to complete the construction of a building over a specified period. However, the arrangement does not provide details such as key milestones or the order in which major construction activities are to occur. In this scenario, application of Option 2 would result in recognition of revenue over the specified construction period.

*Option 3 – Recognition in accordance with obligations in the binding arrangement where non-performance can require a return of resources (analogous to performance obligation approach)*

24. Option 3 allows for analogous accounting to that in ED 70, without modifying the definition of a performance obligation in ED 70. This option allows the recognition of a liability upon the receipt of capital grants to defer the revenue over the performance period based on the grant terms. The accounting requirements for these transactions should be sufficiently narrow so that only enforceable capital grants with arrangements that include terms that are sufficiently specific (meaning those with specific deliverables which would have otherwise met the definition of a performance obligation in ED 70, but do not because of the lack of transfer of goods or services to the purchaser) are captured.
25. Proponents of this view argue that the only reason the grant terms are not performance obligations is because of the requirement in the definition in ED 70 that there be a transfer of goods or services to the purchaser or third-party beneficiary. Therefore, those who support this view believe that capital

grants with characteristics similar to revenue with performance obligations should be treated consistently with ED 70.

26. Under this option, if a grant agreement requires the grant recipient to complete certain specific actions, each action may be considered a specific obligation. Revenue is recognized as the specific obligations as per the terms of the agreement are satisfied.
27. For example, a capital grant requires the construction of a building, and the agreement sets out details such as the specific activities to be performed by the resource recipient, the timing of such activities, and mechanisms for the assessment of progress. The terms also state that failure to meet the requirements would result in a full or partial refund of the grant, depending on what activities have been satisfactorily performed to date. Application of Option 3 to this scenario would result in the recognition of revenue as specific activities have been performed.

**CAG Question:**

**Which of the above accounting options do CAG members think better serves the public interest, and why?**

**What additional information, such as examples, do CAG members think should be developed to better illustrate the above options?**

**Appendix A: Reference Examples**

1. The following examples portray hypothetical situations which illustrate the various accounting options discussed in the paper. In practice, capital grant agreements are often complex and will require a detailed analysis of the terms of the agreement, as well as consideration of all relevant facts and circumstances, to determine the appropriate accounting treatment. The following situations have been simplified for illustrative purposes and reflect the staff's preliminary analysis.

*Reference Example 1*

2. A government has entered into a grant agreement with an entity and provided the entity with CU10 million upon signing of the agreement to construct a building over a 4-year period. The grant agreement does not contain terms regarding how the building is to be operated upon completion, nor does the agreement contain any terms requiring the return of the grant if the money is not used to construct the building.
3. In this case, Option 1, immediate recognition of the CU10 million received as grant revenue, appears to be the most appropriate accounting treatment for this transaction, as the terms of the grant agreement do not require the return of funds if the resources are not used to build a building, and therefore, the entity has no present obligation.

*Reference Example 2A*

4. A government has entered into a binding grant agreement with an entity and provided the entity with CU10 million upon signing of the agreement to construct a building over a 4-year period. Unlike example 1, the grant agreement states that if the building is not completed by the end of the 4<sup>th</sup> year, the government has the right to a full or partial refund depending on the stage of completion of the building. The agreement does not provide specific directions on how construction is to be completed or any details on how much of the grant relates to each stage of completion. There are also no specified directions on how the entity is to use the building after completion.
5. In this example, recognition of the CU10 million into revenue on a straight-line basis over the 4-year period, or Option 2, appears to be the most appropriate. This is because while the entity has an overall requirement to complete the building in four years, there are no specific requirements on when the various key stages of construction are to be completed or how much of the grant relates to each stage of completion.

*Reference Example 2B*

6. In contrast, a different conclusion may be reached if the agreement in Example 2A provided more specificity over what specific stages of construction are to be completed and how much of the grant relates to each stage. For example, the agreement could specify that:
  - CU3 million is for completion of the foundations and ground work;
  - CU3 million is for completion of the building exterior;
  - CU2 million is for completion of the interior walls; and
  - The remaining CU2 million is for fittings and fixtures such as wiring and carpeting.

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In this case, it may be most appropriate for the entity to apply Option 3 and recognize revenue as each stage of construction is completed.

### *Reference Example 3*

7. A government has entered into a similar grant agreement as Example 2A with an entity. In addition to the requirement for completing the building in 4 years for CU10 million, the government is also paying an additional CU5 million to require the entity to operate the building as a clinic and provide measles vaccinations to local children for 10 years after the completion of the building. For simplicity, it is assumed that the appropriate allocation of the CU15 million grant is CU10 million for the construction of the building and CU5 million for provision of the vaccines.
8. In this example, the grant consists of the CU10 million capital grant component relating to construction of the building in the first 4 years, and an operating grant component relating to the CU5 million for the provision of vaccines in the subsequent 10-year period.
9. Since the capital component of this grant is the same as Example 2A, Option 2 appears to be the most appropriate accounting treatment for this component.
10. For the operating component, the government is acting as the purchaser in an arrangement by paying funds to the entity for the provision of vaccines to local children, a third-party beneficiary. The terms of this arrangement appear to satisfy the definition of a performance obligation and should be in scope of ED 70, as noted in Diagram 1, because: 1) the arrangement is binding, and 2) the arrangement has performance obligations, as the provision of vaccines to local children meets to requirement to transfer specific goods or services to the purchaser or third-party beneficiary. Therefore, the revenue relating to the provision of vaccines should be recognized using the ED 70 revenue recognition model.



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

Project: Revenue

#	Due Process Requirement	Yes/No	Comments
<b>A. Project Brief</b>			
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 <a href="#">Agenda Item 10</a> ).
A2.	The IPSASB has approved the project in a public meeting.	Yes	See the minutes of the <a href="#">March 2015 IPSASB meeting (section 10)</a> .
A3.	The IPSASB CAG has been consulted on the project brief.	N/A	This step was not in effect for this project.
<b>B. Development of Proposed International Standard</b>			
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 <a href="#">Consultation Paper, Accounting for Revenue and Non-Exchange Expenses in August 2017</a> .
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, all comments received have been publicly posted on the website. The IPSASB has deliberated the feedback received at public IPSASB meetings in forming its views on how to develop the revenue exposure drafts.
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.	Yes	Agenda Item 5 from the June 2018, and agenda item 7 from December 2018 meetings sought the CAG's views on the significant issues to be address in the development of the exposure draft.  This Agenda Item further seeks CAG's views on significant issues to be addressed in the development of the exposure draft.
<b>D. Consideration of Respondents' Comments on an Exposure Draft</b>			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the	NA	The IPSASB is still in the process of developing Exposure Drafts on revenue.

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#	Due Process Requirement	Yes/No	Comments
	exposure draft and the IPSASB's related responses.		
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the 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.	N/A	

**Appendix C: Links to Other Documents**

1. 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 *Accounting for Revenue and Non-Exchange Expenses* Webinar