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Meeting:	International Public Sector Accounting Standards Board	**Agenda Item 7**	For:
Meeting Location:	Toronto, Canada		☐ Approval ☒ Discussion ☐ Information
Meeting Date:	June 23–26, 2015		

Non-exchange Expenses

Objective(s) of Agenda Item

1. The objective of this agenda item is to:

   (a) Provide background information on the current state of accounting and financial reporting for the provision of non-exchange transactions

   (b) Introduce for discussion purposes issues associated with the scope of the Non-exchange Expenses Project

   (c) Introduce for discussion purposes potential modifications to the definition of non-exchange transactions

   (d) Identify basic recognition approaches for the provision of public sector non-exchange transactions other than social benefits

Materials Presented

Agenda Item 7.1 Issues Paper, *Non-exchange Expenses*

Action(s) Requested

2. The IPSASB is asked to:

   (a) **Review** the Issues Paper.

   (b) **Review** the background on accounting and financial reporting of nonexchange transactions.

   (c) **Decide** on a preliminary scope for the non-exchange expenses project.

   (d) **Consider and potentially decide** on a tentative definition of non-exchange.

   (e) **Suggest** additional recognition criteria that should be considered for non-exchange expense transactions other than social benefits.

ISSUES PAPER, *Non-exchange Expenses*

Objectives of this Paper

1. This Issues Paper explores the boundaries of the non-exchange expenses project, so that the Board can consider an approach for establishing the tentative scope of the project. The paper also introduces potential modifications to the definition of non-exchange transactions. Finally, the paper seeks input on the types of recognition approaches related to the provision of public sector non-exchange transactions that will be further explored at the IPSASB's September 2015 meeting.

Background

2. Public sector entities provide resources through non-exchange transactions to a wide variety of entities (not-for-profit entities, for profit entities, public sector entities) or individuals. The provision of non-exchange transactions also can involve many forms—from those that are clearly non-exchange in nature to transactions where the line between exchange and non-exchange is not so crystal clear. This issue is explored further in the discussion of project scope that is presented later in this paper.

3. This project is referred to as non-exchange expense; however, as discussed below, some of these transactions may not result in the immediate or ultimate recognition of an expense in the financial statements. Therefore, this paper refers to this type of transaction as the provision of non-exchange transactions.

Current Guidance

4. To begin the discussion of how to account for and report the provision of nonexchange transactions, it is important to consider current IPSASB literature and proposals, statistical literature, and related pronouncements from other standards setters in order to place the issues being considered in this project in context.

5. This section of the paper includes a discussion of IPSASB literature, the guidance of other standard-setting organizations for both exchange and non-exchange transactions, and International Monetary Fund (IMF) literature related to non-exchange transactions. The following items are addressed:

   - IPSASB, *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*
   - IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*
   - IPSAS 23*, Revenue from Non-exchange Transactions*
   - IPSAS Consultation Paper, *Recognition and Measurement of Social Benefits*
   - IMF, *Government Finance Statistics Manual (2014)*
   - International Financial Reporting Standard 15, *Revenue from Contracts with Customers*
   - Canadian Public Sector Accounting Board, PS 3410, *Government Transfers*
   - New Zealand Treasury*, Guidance on Recognising Liabilities and Expenses (2013)*
   - Federal Accounting Standards Advisory Board (United States), Statement of Federal Financial Accounting Standards 5: *Accounting for Liabilities of the Federal Government (1995)*

- Governmental Accounting Standards Board (United States)
  - Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*
  - Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*
  - Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*
  - Statement No. 65, *Items Previously Reported as Assets and Liabilities*
  - Statement No. 70, *Accounting and financial Reporting for Nonexchange Financial Guarantees*

Existing IPSASB Guidance – IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets

6. There is currently one International Public Sector Accounting Standard (IPSAS) that applies to some aspects of the provision of nonexchange transactions; IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* (October 2002). IPSAS 19 was issued more than a decade ago and was primarily drawn from International Accounting Standard (IAS) 37, *Provisions, Contingent Liabilities and Contingent Assets.* The IAS was not developed with non-exchange transactions in mind; therefore, the IPSASB specifically excluded social benefits from the scope of IPSAS 19.

7. IPSAS 19 defines contingent assets, provisions and contingent liabilities, and identifies how these transactions and other events should be recognized and measured. It also provides disclosure requirements related to those transactions. The Statement distinguishes between *provisions*, which are recognized as liabilities, and *contingent liabilities*, which are not recognized. IPSAS 19 explains that all provisions are distinct from other liabilities such as payables and accruals because the timing or amount of future expenditure required to settle a provision is uncertain.

8. A provision is recognized when (1) an entity has a *present obligation* (legal or constructive) as a result of a past event; (2) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (3) a reliable estimate can be made of the amount of the obligation. In considering what is a present obligation, paragraph 51 of IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* adds that a present obligation is a "duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts." It should be noted that the IPSASB Conceptual Framework defines a present obligation as "a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid."[1]

9. IPSAS 19 acknowledges that, in some circumstances, it may be unclear whether a present obligation exists. In those cases, a past event (*obligating event*) is considered to give rise to a present obligation if it is more likely than not that a present obligation exists at the reporting date. If it is not more likely than not that a present obligation exists, than the entity discloses a contingent liability unless the possibility of a resource outflow is remote.

[1] Conceptual Framework, paragraphs 5.14-5.15.

10. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only where the settlement of the obligation (a) can be enforced by law, or (b) the event creates valid expectations in other parties that the entity will discharge the obligation (as is the case for a constructive obligation).

11. The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the reporting date. This is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. In circumstances where the effect of the time value of money is material, the amount of the provision that is recognized should be the present value of the expenditures expected to be required to settle the obligation. IPSAS 19 allows entities to consider the impact of future events—such as the effect of possible new legislation, inflation, or technological developments—on the amount of the liability that is recognized.

Proposals in the Consultation Paper, Recognition and Measurement of Social Benefits

12. The IPSASB reviewed a draft of the Consultation Paper (CP), *Recognition and Measurement of Social Benefits* at the March 2015 meeting. The focus of that CP is a subset of the provision of non-exchange transactions identified as social benefits. Consistent with the definition of social benefits found in Government Finance Statistics (GFS), the CP defines social benefits as “benefits payable to individuals and households, in cash or in kind, to mitigate the effect of social risks.” Social risks are defined in the paper as “events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or reducing their income.” Examples of programs that fall within the scope of that project include social assistance and social security programs. Excluded from the scope of that project are employment related social insurance programs (which are covered by IPSAS 25, *Employee Benefits)*, and other types of in-kind transfers and collective goods and services, which are to fall within the scope of the project as proposed in this paper.

International Monetary Fund (IMF), Government Finance Statistics Manual

13. As noted above, the CP on social benefits proposes adopting the definitions related to social benefits that are consistent with those provided in Government Finance Statistics Manual (GFSM). The GFS framework is based on the *System of National Accounts 2008* (SNA). This framework also was considered in the development of the social benefits CP.

14. The pre-publication draft of the GFSM defines a transaction as “an economic flow that is an interaction between institutional units by mutual agreement or through the operation of the law, or an action within an institutional unit that is analytically useful to treat like a transaction, often because the unit is operating in two different capacities.”[2] Transactions can be monetary or nonmonetary.

15. The GFSM provides that monetary and nonmonetary transactions can be further categorized into one of two types: (1) exchange transactions and (2) transfers. Transfers are defined as “a transaction in which one institutional unit provides a good, service, or asset to another unit without receiving from the latter any good, service, or asset in return as direct counterpart.”[3] Transfers also include circumstances when the value provided in return for an item is not economically significant or much below its value. The notion of transfers in the GFSM includes transactions that can be described as nonexchange revenues and nonexchange expenses.

[2] Government Finance Statistics Manual (GFSM), 3.5.
[3] GFSM, 3.10, 3.19-3.21.

16. The GFSM notes that some transactions are a combination of an exchange and a transfer. Such transactions should be partitioned and recorded as two transactions, one that is only an exchange, and one that is only a transfer.[4]

17. The GFSM also further divides monetary transfers into one of two varieties: (1) current and (2) capital. Capital transfers generally refer to transfers of all assets other than cash and inventory. Current transfers consist of all transfers that are not capital transfers. The GFSM notes that current transfers "directly affect the level of disposable income and influence the consumption of goods or services." These include social benefits, subsidies, and food aid.[5]

18. The GFSM provides that transactions should be recorded on the accrual basis when "economic ownership changes hands for goods, non-produced non-financial assets and financial assets and liabilities, when services are provided, and for distributive transactions when the related claims arise."[6]

19. As a general principle, the GFSM notes that expenses should be recorded when the activities, transactions, or other events occur that create the "unconditional obligation to make payments or otherwise give up resources." The GFSM establishes an economic expense classification scheme that categorizes expenses based on the process involved. A government either (a) directly incurs expenses in producing goods and services, (b) purchases goods and services from a third party and distributes them, or (c) transfers cash to households so they can purchases goods and services directly. Included in the transfers category are four type of nonexchange expense: (1) subsidies, (2) grants, (3) social benefits, and (4) transfers other than grants.[7]

20. Some of these classifications of transaction type have been considered in the development of this paper and may be useful to organizing thinking about this project's scope.

21. The GFSM provides that subsidies are current unrequited transfers that government units make to enterprises on the basis of the level of their production activities or the quantities or values of the goods or services they produce, sell, export, or import. Subsidies include payable tax credits receivable by enterprises for these purposes. Subsidies are payable to producers only, not to final consumers, and are current transfers only, not capital transfers. [8] Examples of subsidies include:

    - Direct foreign trade subsidies on imported or exported goods and services;
    - Implicit subsidies resulting from the operation of an official system of multiple exchange rates or resulting from payable tax credits;
    - Losses of government trading organizations whose function is to buy products and sell them at prices lower than market as part of a deliberate government policy;
    - Transfers payable to corporations that are intended to compensate for recurrent losses that are incurred as a result of charging prices lower than their average cost of production as a matter of deliberate government economic and social policy;

- Subsidies resulting from the central bank accepting interest rates lower than the prevailing market rates;

[4] GFSM, 3.11.
[5] GFSM, 3.15-3.17.
[6] GFSM, 3.60.
[7] GFSM, 6.3, 6.6.
[8] GFSM, 5.146, 6.84-6.85, 6.90.

- Subsidies on payroll or workforce; and
- Subsidies to reduce pollution.

22. Grants are defined in the GFSM as transfers payable by government units to other resident or non-resident government units or international organizations that do not meet the definition of a tax, subsidy, or social contribution. Grants may be in cash or in-kind.[9]

23. Social benefits are defined in the GFSM as current transfers receivable by households intended to provide for the needs that arise from social risks. Social benefits are classified according to the type of social protection arrangement governing their payment.[10]

24. Under the GFS framework, social protection arrangements are organized into various typologies based on their characteristics. The recording of related liabilities and expenses also is dependent upon the type of arrangement. Such programs are first divided into either *social assistance* or *social insurance schemes* (including social security schemes). These classifications are based on the type of social protection arrangement governing the payment of the benefits. Social security schemes are considered not to result in a contractual liability for the government except for those amounts overdue after all criteria for benefits have been met.[11] The GFSM provides that social assistance benefits should generally be recorded as an expense when all eligibility criteria have been met and the benefits become payable. If a government produces the goods or services provided to households as social assistance benefits, they are classified as an expense incurred in the production of that good or service—for example, employee wages.[12]

IPSAS 23, Revenue from Non-exchange Transactions (Taxes and Transfers)

25. One of the benefits of considering the project on revenues at the same time that the IPSASB deliberates issues pertaining to the provision of nonexchange transactions is the potential to develop or at least consider developing symmetrical accounting and financial reporting standards for nonexchange transactions. The project staff believes that it would be beneficial to at least consider guidance that aligns the accounting and financial reporting for assets, liabilities, revenues, expenses (and other potential elements) arising from nonexchange transactions.

26. The project on revenues is currently examining IPSASB guidance for nonexchange revenue. Current guidance for nonexchange revenues can be found in IPSAS 23, *Revenue from Non-Exchange Transactions (including Taxes and Transfers).*Paragraph 10 of Agenda Item 6.1 summarizes the key principles of IPSAS 23.

International Financial Reporting Standard 15, Revenue from Contracts with Customers

27. The revenue project is considering IFRS 15, *Revenue from Contracts with Customers,* for its potential relevance and applicability to the public sector, including non-exchange revenue transactions.

28. IFRS 15 focuses on *performance obligations* as opposed to IPSAS 23, which focuses on *present obligations*. Under IFRS 15, performance obligations are associated with contracts with customers which contain provisions for the exchange of goods and services between customers. Inherent to this approach is the notion of a customer and the identification of a specific good or service.

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[9] GFSM, 6.92.
[10] GFSM, 6.96, 6.99.
[11] GFSM, 4.48, 6.99
[12] GFSM, A2.18, A2.29, A2.33.

29. As the IPSASB considers whether it is appropriate to adopt the performance obligations approach to certain revenue transactions, the project staff believes that the IPSASB also may concurrently consider the feasibility of adopting at least aspects of this approach to the provision of certain non-exchange expense transactions. This is especially the case if the IPSASB wishes to develop approaches to non-exchange revenues and expenses that mirror one another in certain cases.

30. In March 2015, the South African Accounting Standards Board issued a research paper, *Impact of IFRS 15 Revenue from Contracts with Customers on Revenue in the Public Sector.* That paper analyzed the possibility of adopting the guidance of IFRS 15 for the public sector and concluded that, while certain principles from the approach in IFRS 15 may apply to non-exchange transactions, adopting the proposed guidance "as is" to non-exchange transactions would be difficult. The paper cited some of the challenges in fully adopting the guidance in IFRS 15 to the public sector. Significant issues the paper noted include: (a) non-exchange transactions often arise from statutory rather than contractual arrangements, (b) non-exchange transactions are not executory in nature in that they do not require performance by both parties, and (c) transactions in the public sector often preclude the identification of a specific customer.

Canadian Public Sector Accounting Board (PSAB)

31. The PSAB in Section PS 3410, *Government Transfers* establishes standards on how to account for and report government transfers to individuals, organizations, and other governments from both a transferring government and a recipient government perspective. Within the scope of the Statement are non-exchange transfers of monetary assets or tangible capital assets for which the government making the transfer does not:

    (a) Receive any goods or services in return

    (b) Expect to be repaid in the future

    (c) Expect a direct financial return

    Excluded from the guidance in PS 3410 are:

    (a) Transfers made through a tax system that are authorized through tax legislation;

    (b) Grants in lieu of taxes;

    (c) Settlements of lawsuits or other types of legal compensation provided by governments;

    (d) Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) payments; and

    (e) Transfers of non-monetary assets other than tangible capital assets.

    PS 3410 provides that government transfers do not include:

    (a) Taxes or other money collected by one government on behalf of another government or organization, including local government requisitions; and

    (b) Flow-through arrangements where a government agrees to act merely as an intermediary to administer funds on behalf of another party and has no ability to make decisions regarding the use of the funds.

32. For the purposes of transfer recognition, PS 3410 distinguishes between two types of transfer terms: (1) eligibility criteria and (2) stipulations. Eligibility criteria describe who a recipient must be or what it must do in order to be able to get a government transfer. Stipulations describe how a recipient must

use the transferred resources or the actions it must perform in order to keep the transfer. Eligibility criteria must be met before the transfer is provided, whereas stipulations are met after the transfer is provided. PS 3410 provides that stipulations do not affect the timing of recognition of a transfer in expenses by a transferring government, though they may affect the revenue recognition of a recipient government.

33. PS 3410 does not attempt to create symmetrical accounting by the transferor and recipient of a government transfer. The Section notes that "symmetrical accounting by the parties to a transaction is not a fundamental principle of accounting theory."

34. PS 3410 provides that transferring governments must recognize an expense in the period the transfer is authorized and all eligibility criteria have been met by the recipient. The transfer of a tangible capital asset is recognized as an expense by a transferring government at the net book value of the tangible capital asset transferred. The measurement of the liability or expense arising from the transfer may be impacted by the nature of the eligibility criteria and whether or not the program requires recipients to continually meet eligibility criteria in future periods.

35. For a transferring government, PS 3410 establishes that a government transfer is considered to be authorized when either there is (a) evidence that the enabling authority to provide a transfer is in place and an exercise of authority under that approved legislation, regulations or by-laws has occurred, or (b) the actions and communications of the transferring government by the financial statement date clearly demonstrate that it has lost its discretion to avoid proceeding with a transfer and final approval in the stub period of the enabling legislation, regulations, or by-laws confirms that the transferring government was demonstrably committed to approving and proceeding with the transfer at the financial statement date.

36. In November 2014, the PSAB began a Post-Implementation Review of Section PS 3410. Written comments from stakeholders were requested no later than May 15, 2015. The PSAB asked stakeholders to provide feedback on the guidance related to certain areas about which issues were identified, including:

    - Recipient revenue recognition of capital transfers
    - Authorization required for transfer recognition (at which point a transferring government loses its discretion to provide a transfer, and at which point a recipient gains control of resources that meet the definition of an asset)
    - Interpretations of the distinction between eligibility criteria and stipulations

New Zealand Treasury, Guidance on Recognising Liabilities and Expenses (2013)

37. The New Zealand Treasury's *Guidance on Recognising Liabilities and Expenses* summarizes Generally Accepted Accounting Practices established by the New Zealand Accounting Standards Board (NZASB). The pronouncement provides interim application guidance for the recognition of liabilities arising from nonexchange transactions that are uncertain in timing or amount.

38. The NZASB has generally adopted the guidance on provisions and constructive obligations introduced in IPSAS 19. However, one exception exists in that the guidance in IPSAS 19 is not applied in accounting for obligations of the Crown expressed in legislation that have characteristics similar to an executory contract. Obligations that have characteristics similar to an executory contract are those where: (1) the Crown is obligated to provide goods, services, or transfers to the community in future periods using funding to be obtained from the community substantially in those periods; and

(2) the intended third party recipients of the goods, services or transfers have not yet satisfied the criteria for entitlement to those goods, services, or transfers.

39. Because the general approach to accounting for non-exchange expenses in New Zealand is derived from IPSAS 19, the document focuses primarily on determination of the present obligation that arises as a result of a past event. It presents a systematic approach to determining whether or not a liability or expense should be reported as a result of a nonexchange transaction. The application guidance suggests that consideration must first be given to the following factors in making such a determination:

- Is there a possible obligation involving economic sacrifice?
    - Is the lack of economic sacrifice due to reimbursement of possible obligation?
- Is the possible obligation ongoing and adjustable?
- Does the possible obligation arise pursuant to an exchange contract?
- Does the possible obligation arise pursuant to legislation or a deed?
- Does the possible obligation arise pursuant to a government policy?

40. The pronouncement sets forth criteria that are intended to assist financial statement preparers in making a determination about whether to report a potential obligation. For instance, a public sector entity might not recognize an expense if an expected reimbursement related to that expense is sufficiently certain and sufficiently integrated with that expense. The application guidance also iterates that expenses attributable to future periods that are clearly adjustable and ongoing would not be reported as obligations in the present reporting period. The document also sets forth the criteria to be used for determining when a present obligation arises pursuant to an exchange contract, a legislation or a deed, or pursuant to a government policy.

(United States) Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards (SFFAS) 5: Accounting for Liabilities of the Federal Government (1995)

41. The FASAB's SFFAS 5, *Accounting for Liabilities of the Federal Government,* defines the recognition points for liabilities associated with exchange transactions, non-exchange transactions, government-related events, and government acknowledged events. The SFFAS sets forth different approaches to accounting for liabilities arising from exchange and nonexchange transactions.

42. The general principal applied to obligations arising from non-exchange transactions of the United States Federal government is that liability recognition occurs when a payment is due and payable. This notion includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program as of the federal entity's reporting date, even if such amounts have not been reported to the federal entity. This would include, for example, estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity.

(United States) Governmental Accounting Standards Board (GASB)

43. The GASB has issued five currently effective statements that address accounting and financial reporting for nonexchange transactions:

- Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*

- Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*
- Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*
- Statement No. 65, *Items Previously Reported as Assets and Liabilities*
- Statement No. 70, *Accounting and financial Reporting for Nonexchange Financial Guarantees*

44. Statement 24 was a narrowly-scoped standard that addressed on-behalf payments, food stamps, and pass-through grants. The Statement provides that pass-through grants are those grants that are received by a recipient government to transfer to or spend on behalf of a secondary recipient. As a general rule, recipient governments should recognize all cash pass-through grants as revenue and expenses. In those infrequent cases in which a recipient government serves only as a cash conduit—that is, it has no administrative or direct financial involvement in the program—the grant should be reported in an agency fund (not in the government-wide, accrual-based financial statements. This Statement also requires state governments to recognize their distributions of food stamp benefits as revenue and expense whether the benefits are in paper or electronic form. State governments should report food stamp balances held by them or by their agents at the balance sheet date as an asset.

45. Statement 33 is applicable to state and local governments in the United States and addresses provider and recipient reporting for resources in nonexchange transactions involving financial and capital resources. Contributed services, food stamps, and on-behalf payments for fringe benefits and salaries are excluded from the Statement's scope. As previously noted, food stamps and on-behalf payments were specifically addressed in Statement 24.

46. Statement 33 identifies four types of non-exchange transaction which are distinguished from one another based on their principal shared characteristics:

    1. Derived tax revenues (for example, sales and income taxes)
    2. Imposed nonexchange revenues (for example, property taxes, fines, penalties)
    3. Government-mandated nonexchange transactions (for example, Federal government mandates on state and local governments)
    4. Voluntary exchange transactions (for example, other grants and entitlements and gifts)

47. The Statement requires governments that are resource providers to recognize expenses and liabilities arising from government mandated and voluntary nonexchange transactions in the period in which all *eligibility requirements* have been met. The GASB determined that application of the enforceable legal claim notion may not be appropriate to recognition for these transactions because the recipient government generally has no power to force the transmittal of the promised resources nor is it likely to take action to obtain those resources. Eligibility requirements are conditions established by enabling legislation or the provider that are required to be met before a transaction can occur. Statement 33 identifies four possible types of eligibility requirements:

    1. Required characteristics of recipients
    2. Time requirements
    3. Reimbursement (associated with a performance obligation)
    4. Contingencies

If the provider precludes the sale, disbursement, or consumption of resources for a specified number of years, until a specified event has occurred, or permanently but permits the recipient to benefit from the resources, the provider should report the expense when the resources are transferred.

48. For accrual financial statements, recognition of non-exchange transactions that meet the eligibility requirements is required unless the transactions are (1) not measurable (reasonably estimable), or (2) are not probable of collection. Transactions that are not recognized because they are not measurable should be disclosed.

49. Statement 33 provides that purpose restrictions without any eligibility requirements do not affect the timing of recognition by either the resource provider or recipient. Rather, purposes restrictions affect the recipient reporting of resources (as restricted).

50. In some cases, a subsequent contravention of eligibility requirements or purpose restrictions may occur. A contravention occurs when (a) the eligibility requirements are no longer met or (b) the resource recipient will not comply with the purpose restrictions within the specified time limit. If a contravention of eligibility requirements or purpose restrictions occurs and it is probable that the provider will not provide the resources or will require the recipient to return all or part of the resources already received, the resource provider should recognize a decrease in liabilities (or increase in assets) and revenue for the amount that the provider is expected to cancel or reclaim.

51. The GASB excluded from Statement 33's scope certain exchange-like transactions which contain an identifiable exchange between the reporting government and another party, but the values exchanged may not be quite equal or the direct benefits of the exchange may not be exclusively for the parties to the exchange. These transactions include certain fees for regulatory or professional licenses, certain developer contributions, certain grants and donations, and other transactions. The GASB determined that these transactions should be accounted for in the same manner as other exchange transactions, rather than as non-exchange transactions.

52. The GASB also developed the guidance under the assumption that, when both parties to a non-exchange transaction are governments, recognition generally should be symmetrical. The Statement was developed such that the guidance would result in the reporting of assets and revenues by recipients to coincide with the reporting of liabilities and expenses by providers. Statement 36 amended Statement 33 to achieve this symmetry for the purposes of reporting shared tax revenues. It aligned the timing of recipient recognition of shared tax revenues with that of the provider's disbursement of the resources. The Statement requires governments that receive a portion of another government's derived tax revenues or imposed non-exchange revenue to follow the accounting guidance for government-mandated and voluntary non-exchange transactions.

53. The Financial Accounting Foundation (FAF) is currently reviewing Statement 33 and Statement 36 as part of its Post-Implementation Review process.

54. Statement 65 introduced the notion of deferrals to accounting for non-exchange transactions. Resource providers that transmit resources before the eligibility requirements are met (excluding time requirements) should report those resources as assets. Resource recipients should report the resources as liabilities. However, if all eligibility requirements other than *time requirements* have been met, the transferred resources should be reported as a deferred outflow of resources by the provider and a deferred inflow of resources by the recipient.

55. Statement 70 provides specific guidance regarding the recognition and measurement of non-exchange financial guarantees. This Statement describes non-exchange financial guarantees as guarantees that arise when one government guarantees financial obligations of another government, non-governmental entity, or individual without receiving equal or approximately equal value in return. Statement 70 provides accounting and financial reporting guidance for both providers and recipients of such guarantees.

56. Statement 70 requires governments to consider certain qualitative factors in assessing the likelihood that a government will be required to make a payment related to the nonexchange financial guarantee. If, based on an assessment of qualitative factors (including bankruptcy proceedings, covenant breaches, and indicators of significant financial difficulties), a government that has entered into a non-exchange financial guarantee determines that it is more likely than not that it will be required to make payment, that government should recognize a liability and expense in financial statements prepared using the accrual basis of accounting. The amount recognized should generally be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee.

IPSASB

The Conceptual Framework

57. The goal of any proposed guidance associated with the provision of non-exchange transactions is consistency with the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework).

58. The Conceptual Framework introduced updated definitions of an asset, a liability, and related terminology. These definitions will influence the discussion of the recognition of the provision of non-exchange transactions. When one views the basic provision of non-exchange transactions, the recognition of expense automatically comes to mind, thus the name of the project. However, if a resource is provided in advance, an asset could result. Moreover, in certain circumstances, based on discussion in the basis for conclusion of the elements portion of the Conceptual Framework, accepting that certain economic phenomena that do not meet the definition of any element may not provide all the information in the financial statements that is necessary to meet users' needs, the use of an additional item may be necessary.

59. The Conceptual Framework also establishes the objectives and the qualitative characteristics of financial reporting, which provide a framework against which various approaches introduced later in this paper can be evaluated.

60. The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial reports for accountability purposes and for decision-making purposes. The results of any final guidance related to the provision of nonexchange transactions may be relevant to meeting a variety of information needs of service recipients and resource providers, including assessing an entity's:

- Performance during the reporting period
- Liquidity and solvency
- Ability to sustain the services it delivers and other operations over the long term
- Capacity to adapt to changing circumstances

Matter(s) for Consideration

1. The IPSASB is **asked** to identify any additional authoritative or non-authoritative literature that should be considered during the course of this project.

Key Issues

Scope

61. The tentative decisions made by the IPSASB to address non-exchange revenues as part of an overall revenue project and to address social benefits in a project separate from other provisions of non-exchange transactions, have a significant effect on the scope of this project.

62. As noted earlier, existing guidance for accounting and financial reporting for the provision of non-exchange transactions is found in IPSAS 19. IPSAS 19 was derived from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* which was not developed with nonexchange transactions in mind. Without specific guidance, those that have applied IPSASs in practice have either attempted to analogize the non-exchange revenue guidance found in IPSAS 23 or develop their own guidance (for example, New Zealand) or policies to address the effects that other requirements not traditionally found in private transactions have on whether a present obligation exits.

63. At the heart of defining the scope for this project lies the question: What is a non-exchange transaction? The definition of non-exchange on the surface appears to be clear. However, how people interpret the definition and operationalize the definition can vary significantly. The variations in interpretation and operationalization arise from two distinct yet interrelated issues relevant to transactions that are encountered in the public sector operating environment.

64. The first pertains to the fact that, unlike in the private sector, many public sector activities may potentially be defined as non-exchange in nature. Public sector entities regularly participate in transactions for which they either (1) do not receive equal, or approximately equal, consideration for services or resources they provide or (2) receive consideration the value of which cannot be precisely measured. As a result, many (and a few might argue all) transactions entered into by a public sector entity with the exception of government business enterprise (GBE) activities could be classified as non-exchange.

65. As illustrated in Exhibit A, taken to one extreme, one could argue that all transactions that a public sector entity participates (except GBE activities) in are fundamentally non-exchange. This notion is based on the premise that a public sector entity is not involved in activities for the benefit of itself, but rather it ultimately engages in transactions on behalf of its citizens. At the other extreme is the counterpoint to this argument: the notion that all transactions in which a public sector entity partake in which there this are performance obligations are fundamentally exchange in nature.

Exhibit A: Approaches to Classifying Government Transactions - Exchange and Nonexchange

Types of Government Provisions	Most Transactions are Exchange						All Transactions are Nonexchange	Degree of Government Control in Directing the Use of Resources Transferred to a Recipient
Payments for goods (government holds title)	X	X	X	X	X	X		Most Control
Payments for services	X	X	X	X	X			
Payments for contracts	X	X	X	X				
Grants with conditions	X	X	X					
Grants requiring specific performance	X	X	X					
Grants requiring general performance	X	X	X					
Grants with restrictions	X	X						
Grants requiring specific performance	X	X						
Grants requiring general performance	X	X						
Subsidies	X							
Requiring specific performance	X							
Requiring general performance	X							
Social benefits								
Grants with no stipulations								Least Control

Exhibit A: Legend	
Exchange Transaction	X
Nonexchange Transaction	

66. In considering these two extremes, it may be useful to identify who are the “entities” that benefit from these transactions. Outside the public sector environment, the classification of transactions is relatively straight forward. For example, a private sector entity purchases equipment in an arms-length transaction or pays an employee for a day work. No one would question that these transactions are clearly exchange in nature—the private sector entity receives the benefit. However, in the public sector, the parties participating in the transaction, and thus the objective of the underlying transaction, are not always clear.

67. When a local public sector entity pays a school teacher a salary, who is the recipient of the services that the school teacher provides for the salary? Clearly, there is an exchange transaction between the public sector entity and the teacher (the public sector entity acquires and controls the right to use the teacher’s services). However, there is a second part of the overall transaction. The public sector entity does not charge tuition for education; therefore, the public sector entity does do not receive equal, or approximately equal, consideration for educational services they provide. Thus, the second part of the transaction is nonexchange in nature. Although this analysis is theoretically sound (there is a non-exchange transaction), in practice neither the right to use asset or the non-exchange transaction is reported. Instead, the teacher’s salary is expensed using exchange transaction guidance. While the provision of services is clearly non-exchange in nature, determining whether the first part of the transaction should be classified as exchange or non-exchange becomes more difficult to determine when additional parties are introduced into the provision of services.

68. To explore the points introduced above, the project staff selected seven transactions for further consideration.

Transaction 1—A provincial government pays a doctor (an employee) to provide mental health services to a specific community.

Transaction 2—A provincial government enters into a contract with a physicians’ practice (a private sector vendor) to provide mental health services to a specific community.

Transaction 3—A provincial government provides a grant to a not-for-profit organization to provide mental health services to a specific community.

Transaction 4—A provincial government provides a grant to a local government to provide mental health services.

Transaction 5—A provincial government provides a stipend to individuals in a local government that can only be used to obtain mental health services.

Transaction 6—A provincial government provides a grant to a local government; the local government is free to use the grant in any manner. A portion of the grant could be used to provide mental health services.

Transaction 7—A provincial government provides a stipend to individuals; individuals are free to use the stipend in any manner. A portion of the stipend could be used to obtain mental health services.

69. If the IPSASB agrees that each of these overall transactions include a second portion that is non-exchange in nature; then the question that may provide some insight as to whether exchange or non-exchange transaction should be applied is—is the first portion of the transaction an exchange transaction or a non-exchange transaction. As highlighted in the previous teacher salary example, the first transaction has been traditionally viewed as exchange in nature. In Transaction 1, the provincial government acquires a right to the services of the doctor in an arm's length transaction.

70. The same conclusion could be reached regarding the Transaction 2. The provincial government has acquired a resource (the right to use the physicians' practice services). Because the transaction between the provincial government and the physicians' practice is an arm's length transaction, the presumption is that each party receives value from another party while directly giving approximately equal value in exchange.

71. On the other hand, in Transaction 7, the entire transaction appears to be a social benefit (a non-exchange transaction) based on the description provided in the draft Social Benefits CP. The provincial government does not to acquire a right to any service in an arm's length transaction as a result of providing a stipend to the individual. Transaction 6 also clearly appears to be entirely a non-exchange transaction because the provincial government has not acquired a right to a resource that will be used in the provision of a particular service. However, as the transactions move further from the traditional acquisition of a right to use a particular service in an arm's length transaction (Transactions 3, 4, and 5), then the determination becomes more difficult.

72. In these cases, whether the provincial government obtains a right to a service may be called into question. However, even if it is determined that a right to provide services has been obtained, determining whether each party receives value from another party while directly giving approximately equal value in the exchange also may be called into question when other factors are introduced. For example, when grants are provided that are subject to appropriation, recipients may not receive equal value in exchange for the services provided. In other words, a service provider may not receive compensation for all of the services provided due to appropriation limits. In other cases, additional requirements other than a basic performance obligation are introduced which again makes the determination more difficult (for example, a requirement that the resources could not be expended by the recipient until the following fiscal year).

73. Depending on the country, practice varies as to whether Transactions 3-5 are considered exchange or non-exchange in nature. In some countries, the focus is on the performance obligation and if one exists, the transaction is treated as an exchange transaction. In other countries, the fact that additional requirements or limitations exist also are taken into consideration. Although the project staff does not believe that labels such as grants should be used to determine if a transaction should be classified as an exchange or nonexchange transaction for financial reporting purposes, transactions that are associated with certain labels generally include requirements that extend beyond the basic performance obligation found in exchange transactions. As noted in the discussion of the definition of non-exchange transactions, the project staff believes that those requirements and limitations should be taken into account when identifying a non-exchange transaction.

74. That said, the project staff believes that when developing accounting and financial reporting guidance for non-exchange transactions, the existence of a performance obligation is a distinguishing factor. If an arrangement between a public sector entity and a private sector entity, a not-for-profit entity, another public sector entity, or an individual, includes a performance obligation without any additional requirements or limitations, then the transaction should be accounted for as an exchange transaction. If additional requirements or limitations exist beyond performance obligations, then the transaction would be classified as a non-exchange transaction and would be addressed within the scope of this project. Moreover, a non-exchange transaction where a performance obligation does not exist, other than a social benefit, would be in the scope of this project.

Matter(s) for Consideration

2. The IPSASB is **asked** to consider whether the project should encompass transactions with performance obligations and other requirements or limitations and transactions without performance obligations (excluding social benefits),

Definition of non-exchange transactions

75. Non-exchange transactions are currently defined in IPSAS 9, *Revenue from Exchange Transactions*, paragraph 11 as:

> 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.

76. The preface of the IPSASB's Conceptual Framework, paragraph 5 (which is not currently in the Handbook) also includes a description of non-exchange transactions that is based on the IPSAS 9 definition:

> In a non-exchange transaction, an entity receives value from another party without directly giving approximately equal value in exchange.

While the current definition of non-exchange is fundamentally sound, it can be improved. For example, the current definition begins with what the transaction is not. Paragraph 11 of IPSAS 9 then provides the core definition of what a non-exchange transaction is. However, as it is written, that paragraph reads as if though the first sentence defines a non-exchange transaction and the second sentence merely provides a description of such a transaction. Revising this definition could enhance its understandability. However, as noted in the discussion of the scope of the project, a revised definition that is based entirely on the current literature may not provide the clarity that is necessary to appropriately distinguish an exchange transaction from a non-exchange transaction.

77. Based on the current definition it is sometimes difficult to determine if a transaction meets the definition of an exchange or non-exchange transaction when a performance obligation exists. In these cases, additional qualifying characteristics may help distinguish exchange and non-exchange transactions. In exploring potential characteristics, titles or labels were assessed, but rejected. For example, a grant may not always be classified as a non-exchange transaction.

78. On the other hand, the presence of a qualifying characteristic such as a performance obligation does not always result in a transaction being classified as an exchange transaction. As noted in the scope section of this paper, when a performance obligation exists it is sometimes difficult to determine if the "performance" results in an equal exchange, particularly in situations where other requirements or limitations exist.

79. In light of the project scope discussion, the project staff recommends that the following definition for non-exchange transactions be proposed in any forthcoming due process document:

> A transaction in which 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 often are subject to certain requirements or limits, other than performance obligations, that are not present in exchange transactions.

Matter(s) for Consideration

3. The IPSASB is **asked** to decide whether it supports retaining the current IPSAS 9 definition of a non-exchange transaction, the definition of a nonexchange transaction noted above, or would prefer to develop a different definition of a nonexchange transaction.

Recognition

80. The selection of recognition criteria for this project in part will be informed by the IPSASB's decision regarding the project scope. If the IPSASB agrees with the project staff recommendation, then this project will focus on establishing recognition criteria for the provision of non-exchange transactions with performance obligations, taking into account additional requirements or limitations, and the provision of non-exchange expense transactions without performance obligations, excluding social benefits. Social benefit transactions will continue to be addressed in the social benefits project that is already underway.

81. Irrespective of the determination made by the IPSASB on scope, the project staff believes that the approaches outlined to liability and expense recognition in the CP on social benefits provide a useful overview of recognition approaches that may be considered for other non-exchange transactions. However, the IPSASB's determination on scope could potentially result in some approaches being more relevant than others.

82. The CP identifies three broad approaches to accounting for social benefits, which could potentially be applicable to the recognition and measurement of other non-exchange expense transactions. The approaches identified in the CP are:

    1. The obligating event approach

    2. The social contract approach

3. The insurance approach.

83. The first approach, the obligating event approach, is comprised of five sub-options. The five sub-options each relate to a different scenario in which a present obligation for social benefits may arise. The key distinction between each sub-option is when the present obligation arises. The approach was designed to be consistent with the Conceptual Framework's definition of a liability and to approach accounting for social benefits no differently than from other types of obligations. The five sub-options, organized from the option which would result in earliest recognition to that which would result in latest recognition, are as follows:

(a) Key participatory events have occurred (Event occurs – event may or may not be a criterion);

(b) Threshold eligibility criteria have been satisfied (Criteria initially satisfied);

(c) Claim (Criteria for next payment satisfied);

(d) Approved claim (Criteria for next payment satisfied and claim approved); or

(e) Enforceable claim (Criteria for next payment satisfied, claim approved, and payment date has arrived)

84. Because the obligating event giving rise to the liability differs in each of the five proposed sub-options, the timing of the recognition of the liability under each sub-approach differs. The CP identifies two key factors to be considered in determining when a liability arises for a social benefit:

1. What is the past event (or events) that give rise to a present obligation?

2. When does an entity have little or no realistic alternative to avoid settling the obligation?

The CP notes that these two factors are brought together in the revised definition of an obligating event: "An obligating event is an event that creates a present obligation." Such an event creates a legally binding obligation (Sub-Approach (e) – enforceable claim) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. The difficulty lies in identifying the obligating event.

85. For legally binding obligations, the obligating event is the event that gives rise to the obligation. When considering social benefits, this is the point at which an individual or household has an enforceable claim to their entitlement to a benefit. An obligating event that gives rise to a legally binding obligation can usually be clearly identified. It is often the case that a legally binding obligation will arise at a later point in time than a non-legally binding obligation, resulting in later recognition of a liability. These same threshold could be used for certain other non-exchange transactions with legally binding obligations.

86. For a non-legally binding obligation to give rise to a liability there must be:

- An indication to others that the entity will accept certain responsibilities;
- The creation of a valid expectation; and
- Little or no realistic alternative to avoid an outflow of resources.

87. It is generally more difficult to identify an obligating event that may give rise to a non-legally binding obligation. The CP identifies four circumstances (sub-approaches (a) through (d)) when, in the absence of a legally binding obligation, an obligating event might give rise to a non-legally binding

obligation for social benefits. All of these approaches could be applied to certain other non-exchange transactions.

88. Sub-approach (a) prescribes the earliest recognition of a liability resulting from an obligating event arising from a social benefit program. Under this sub-approach, a key participatory event need merely to have occurred. Such an event leads an individual to have a reasonable expectation of eventually satisfying eligibility criteria for a benefit and requires the public sector entity to recognize a liability for that future benefit before the individual recipient is eligible to receive it. Effectively, a liability would be recognized at some point before the eligibility criteria are satisfied. However, it may be difficult to determine when that point is.

89. Sub-approach (b) would result in the next earliest period of recognition of a liability related to social benefits. Such an approach would require an entity to recognize the entirety of a recipient's potential benefits as a liability at the time the recipient first satisfies all of the eligibility criteria (the threshold criteria). For example, a government would recognize a present obligation for all benefits to be provided to an individual at the time the individual first reaches pensionable age or becomes unemployed. Those who support this notion argue that once the threshold eligibility criteria have been satisfied, a government no longer has a realistic alternative to avoid an outflow of resources, the government has accepted a responsibility to provide benefits, and that individuals or households may have expectations that benefits will be paid in the future.

90. Later recognition of the liability would occur under sub-approach (c), which requires all eligibility criteria for the *next payment* to have been satisfied before the reporting entity recognizes a liability. Under this approach, a requirement that a recipient meet eligibility criteria at a future date affects the recognition of a liability as well as its measurement. The present obligation is limited to the amount of future payments to be made until the next point in time at which eligibility criteria are required to be met. Eligibility requirements may include remaining unemployed or remaining alive. This approach would require entities to recognize liabilities and expenses for claims that have been applied for but not yet approved.

91. Sub-approach (d) (Approved claim) differs from sub-approach (c) in that it would not recognize an expense and a liability for benefits applied for but not yet approved. This approach also differs from sub-approach (e) (Enforceable claim) in that a liability would be recognized even if the recipient could not enforce payment at the reporting date. Those who support this approach present arguments similar to those who support sub-approach (c). Specifically, they argue that, until a claim for a payment is approved, a government has a realistic alternative to avoid an outflow of resources. Furthermore, some argue that a valid expectation does not occur until the beneficiary has met all eligibility criteria.

92. The second broad approach proposed in the CP—the social contract approach—views obligations to provide social benefits by governments as quasi-contractual in nature, and adopt executory contract accounting for social benefits. Under this approach, one party to the contract is a government and the other its citizens (collectively). A government has the obligations to provide one or more social benefits, while its citizens have a collective duty to contribute taxes and other sources of finance to fund the government. The government's obligations are offset by the duty of its citizens to contribute resources and the net liability that a government would report would be zero unless there is evidence that the social contract is 'onerous' because individuals and households will no longer be able to finance the social benefits. As a result, liabilities would generally not be recognized by the public sector entity until legal entitlements have been established. However, if the social contract

were determined to be onerous, then a liability would be recognized immediately. Again, this approach could be applied to certain other non-exchange transactions.

93. The final broad approach, the insurance approach, analogizes accounting for social benefits to accounting for insurance arrangements. There is currently no IPSAS on insurance accounting and the approach proposed in the CP is based on the IASB's Exposure Draft, *Insurance Contracts.* The CP acknowledges that this approach would only be suitable to social programs that require contributions of their participants; as a result, if this approach were adopted, it would be one part of a mixed approach to accounting for social benefits. Based on contribution requirement, the application to other nonexchange transactions would be limited. However, there could be non-exchange financial guarantees that meet this requirement.

94. The scope of the non-exchange expense project should in part be informed by a determination about the approach that should be used to liability recognition, and vice versa. A determination about the recognition criteria will not only inform the timing of liabilities that arise from non-exchange transactions, but could also inform whether or not certain liabilities are recognized at all. This is especially true if it is determined that a broad array of services provided by the government are nonexchange transactions and fall within the scope of this project. If this project were broadly scoped and the approach that resulted in the earliest liability recognition—the key participatory event approach—were adopted, then this guidance could result in governments reporting significant liabilities related to their provision of services. Any service for which a government has a legally mandated duty to provide to recipients for which it does not receive approximately equal value in exchange could be classified as a nonexchange expense. Because liability recognition under this approach precedes the satisfaction of eligibility requirements, entry of a potential service recipient into a jurisdiction could trigger liability recognition for a government. For example, if a government has a legal mandate to provide public education to individuals residing within its jurisdiction, that government would record a liability for its anticipated cost of providing education to all individuals who are expected to eventually participate in the public school system based on demographic and actuarial assumptions.

95. The IPSASB should consider whether it is appropriate to establish a single approach to recognition for all non-exchange transactions, or if it is appropriate to establish different approaches based on the nature of the exchange underlying the transaction. The IPSASB noted that, because programs have different characteristics and operate in different ways, a mixed approach to social benefit accounting might be appropriate. Likewise, a similar strategy may be appropriate for accounting for provision of other nonexchange transactions. This can be achieved by adopting a mixed approach in a single Statement, or by issuing separate Statements to address distinct transaction types.

96. As the IPSASB begins to consider the issues identified in this project and the issues identified in the revenue project, it should remain cognizant of the desirability for developing proposals that result in financial reporting that produces symmetrical results for revenue and expense recognition. If the progress of one project was to advance significantly ahead of progress in the other, the decisions made in one project may result in committing the other project to a particular route.

Matter(s) for Consideration

4. The IPSASB is **asked** to identify any additional recognition approaches or criteria that should be considered for nonexchange expense transactions within the scope of this project.