# Agenda Item 7: Non-exchange Expense

David Bean

IPSASB Meeting

June 23-26, 2015

Toronto, Canada

# Agenda

- Background
  - IPSASB Guidance and Conceptual Framework
  - Other Standard Setters and Literature
- Scope
- Definition
- Recognition and Measurement

# IPSASB Guidance and the Conceptual Framework

- 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*

# Other Standard Setters and Literature (1 of 2)

- International Monetary Fund
  - *Government Finance Statistics Manual (2014)*
- International Accounting Standards Board
  - IFRS15, *Revenue from Contracts with Customers*
- Canadian Public Sector Accounting Board
  - PS 3410, *Government Transfers*
- New Zealand Treasury
  - *Guidance on Recognising Liabilities and Expenses (2013)*

# Other Standard Setters and Literature (2 of 2)

- Federal Accounting Standards Advisory Board (USA)
  - Statement of Federal Financial Accounting Standards 5: *Accounting for Liabilities of the Federal Government (1995)*
- Governmental Accounting Standards Board (USA)
  - 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*

# IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets (2002)*

- Drawn from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*
  - Not developed with non-exchange transactions in mind.
  - Social benefits excluded from scope.
- Provisions (recognized) and Contingent Liabilities (not recognized).
  - Recognize a provision when an entity has a *present obligation* as a result of a past event (*obligating event).*
    - The Conceptual Framework defines a *present obligation* as a "legally binding obligation or non-legally binding obligation, which an entity has little or no realistic alternative to avoid."
    - May be imposed by law or stipulation, or may arise from the normal operating environment.

# IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets (2002)*

- An 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.
  - An obligating event is an event that creates an obligation that the entity has no realistic alternative to settling.
  - This is the case only where:
    - The settlement of the obligation can be enforced by law, or
    - The event creates valid expectations in other parties that the entity will discharge the obligation (as in a constructive obligation).
- The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the reporting date.

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

- Excluded from the project on non-exchange expenses is a subset of non-exchange transactions identified as social benefits in the CP.
  - 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.

# International Monetary Fund (IMF), *Government Finance Statistics Manual*

- Definitions in the CP on social benefits are consistent with those provided in Government Finance Statistics Manual (GFSM).
- The GFSM provides that monetary and nonmonetary transactions can be 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."
  - Transfers also include circumstances when the value provided in return for an item is not economically significant or much below its value.

# International Financial Reporting Standard 15, *Revenue from Contracts with Customers*

- The revenue project is considering elements of IFRS 15, *Revenue from Contracts with Customers,* for its potential applicability to the public sector.
- IFRS 15 focuses on *performance obligations* as opposed to IPSAS 23, *Revenue from Non-exchange Transactions,* which focuses on *present obligations*.
  - Performance obligations are associated with contracts with customers which contain provisions for the exchange of goods and services between customers.

IPSASB

# South African Accounting Standards Board, *Impact of IFRS 15 Revenue from Contracts with Customers on Revenue in the Public Sector*

- Analyzed the possibility of adopting the guidance of IFRS 15 for the public sector.
- Concluded that adopting the proposed guidance “as is” to non-exchange transactions would be difficult.
- Challenges include:
    1. Non-exchange transactions often arise from statutory rather than contractual arrangements,
    2. Non-exchange transactions are not executory in nature in that they do not require performance by both parties, and
    3. Transactions in the public sector often preclude the identification of a specific customer.

# Canadian Public Sector Accounting Board (PSAB), 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 nonexchange transfers of monetary assets or tangible capital assets for which the government making the transfer does not:
  - Receive any goods or services in return
  - Expect to be repaid in the future
  - Expect a direct financial return
- Does not attempt to create symmetrical accounting by the transferor and recipient of a government transfer.

# Canadian Public Sector Accounting Board (PSAB), PS 3410, *Government Transfers*

- Transferring governments must recognize an expense in the period the transfer is authorized and all eligibility criteria have been met by the recipient.
  - 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.

# Canadian Public Sector Accounting Board (PSAB), PS 3410, *Government Transfers*

- A transfer is authorized when:
  - (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.

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

- Interim application guidance for the recognition of liabilities arising from non-exchange transactions that are uncertain in timing or amount.
- Presents a systematic approach to determining whether or not a liability or expense should be reported as a result of a non-exchange transaction.

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

- Consideration must first be given to the following factors:
  - 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?

# Federal Accounting Standards Advisory Board, *Statement of Federal Financial Accounting Standards 5: Accounting for Liabilities of the Federal Government (1995)*

- 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.
  - 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.

# Governmental Accounting Standards Board (GASB)

- 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*

# Governmental Accounting Standards Board (GASB)

- Statement 33 requires governments that are resource providers to recognize expenses and liabilities arising from government mandated and voluntary non-exchange transactions in the period in which all *eligibility requirements* have been met.
- Provider and recipient recognition is symmetrical.
- Four possible types of eligibility requirements:
  1. Required characteristics of recipients
  2. Time requirements
  3. Reimbursement (associated with a performance obligation)
  4. Contingencies

# Matter(s) for Consideration

- Matter(s) for Consideration (1 of 4)

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

# Factors that affect the scope of a project on non-exchange expenses

- Addressing non-exchange revenues as part of an overall revenue project.
- Addressing social benefits as an independent project.

# Defining the scope for the non-exchange expense project

- What is a non-exchange transaction?
  - Definition may appear to be clear on the surface…
  - However, interpretations of the definition and how the notion is operationalized vary significantly.
- What is the source of these variations in interpretation and operationalization?
  - Public sector entities regularly participate in transactions for which they either:
    1. Do not receive equal, or approximately equal, consideration, or
    2. Receive consideration the value of which cannot be precisely measured.

IPSASB

# Defining the scope for the non-exchange expense project

- Many (some might argue all) transactions entered into by a public sector entity could be classified as non-exchange.
  - A public sector entity is not involved in activities for the benefit of itself, but rather it engages in transactions on behalf of its citizens.
- The counterpoint to this argument: the notion that all transactions in which a public sector entity partakes in which there are performance obligations are fundamentally exchange in nature.
- The degree of control an entity has in directing the use of resources that are transferred to a recipient may be used to differentiate between exchange and non-exchange transactions.

# Defining the scope for the non-exchange expense project

- Considering the Two Extremes
  - Outside the public sector, classification is relatively straightforward.
    - Most transactions are clearly exchange in nature.
      - For example: an entity purchases equipment in an arms-length transaction or pays an employee for a day of work.
  - Public sector transactions are not as easily classified.
    - Distinction between exchange and non-exchange is less clear.
    - It is dependent upon the "entity" that ultimately benefits.
      - For example: A public sector entity hires a teacher. Who is the recipient of the services the teacher provides for the salary?
        - » The entity that acquires and controls the right to use the teacher's services (exchange).
        - » The students (and community) who attend the school without paying tuition (non-exchange).

IPSASB

# Defining the scope for the non-exchange expense project

- Non-exchange Classification - Theory vs. Practice
  - There is a theoretical basis to define most transactions of public sector entities as non-exchange.
  - Individual activities are classified as exchange or non-exchange based on certain characteristics.
    - A teacher’s salary is generally expensed using exchange transaction guidance.
    - A transfer payment, such as that of a social insurance program, is accounting for using non-exchange guidance.

# Defining the scope for the non-exchange expense project

- 7 transactions that may all be considered non-exchange:
  - 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.

# Defining the scope for the non-exchange expense project

- What individual features may be used to differentiate exchange and non-exchange transactions?
  - Presence of a performance obligation
  - Equality of the value exchanged
  - Control
  - Eligibility requirements
  - Appropriations

# 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 |

IPSASB

# Defining the scope for the non-exchange expense project

- Project Staff Position
  - Exchange
    - 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.
  - Non-exchange
    - 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.
    - A non-exchange transaction where a performance obligation does not exist, other than a social benefit, would be in the scope of this project.

IPSASB

# Matter(s) for Consideration

- Matter(s) for Consideration (2 of 4)

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).

# Current Definition of Non-exchange

- IPSAS 9, *Revenues from Exchange Transactions*

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

- Conceptual Framework Description of Non-exchange

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

# Potential Improvements to Definition of Non-exchange

- Current definition begins with a description of what the transaction is not, and then proceeds to define the transaction.
- 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 in the definition may help distinguish exchange and non-exchange transactions.

# Proposed Definition of Non-exchange

*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

- Matter(s) for Consideration (3 of 4)

The IPSASB is asked to decide whether it supports retaining the current IPSAS 19 definition of a non-exchange transaction, the definition of a non-exchange transaction noted above, or would prefer to develop a different definition of a non-exchange transaction.

# Selection of Recognition Criteria

- Selection of recognition criteria for this project will be informed by the IPSASB's decision regarding project scope.
- If the IPSASB agrees with the project staff recommendation, then this project will focus on establishing recognition criteria for the provision of:
  - Nonexchange transactions with performance obligations, taking into account additional requirements or limitations, and
  - The provision of nonexchange expense transactions without performance obligations, excluding social benefits.

# Selection of Recognition Criteria

- A potential starting point:
  - 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.
  - The three broad approaches identified in the CP:
    1. The obligating event approach
    2. The social contract approach
    3. The insurance approach.

IPSASB

# Matter(s) for Consideration

- Matter(s) for Consideration (4 of 4)

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

# Next Steps