

Consultation Paper
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Accounting for Revenue and Non-Exchange Expenses

IPSASB

International Public
Sector Accounting
Standards Board®

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

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

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Executive Summary

The IPSASB initiated the project for which this Consultation Paper (CP) is an intermediate output to address a number of issues:

- The operationalization of the exchange versus non-exchange distinction and the value of that distinction;
- The gap in the current IPSASB literature on accounting for non-exchange expenses which may lead to ambiguity and inconsistency of accounting policies in a highly significant area of expenditure;
- Application issues with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*; and
- Convergence with International Accounting Standards Board (IASB) literature, which has diminished with the publication of International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*.

Currently three IPSAS addresses revenue recognition – IPSAS 9, *Revenue from Exchange Transactions*, IPSAS 11, *Construction Contracts* and IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS 9 and 11 are principally based on IAS 11, *Construction Contracts* and IAS 18, *Revenue* and address revenue transactions in exchange arrangements while IPSAS 23 addresses revenue transactions in a non-exchange arrangement. The IPSASB are aware that making this exchange/non-exchange distinction can be problematic and this CP explores options to make this determination easier.

IFRS 15 was issued as a replacement to IAS 11 and 18 and adopts a new performance obligation approach for revenue recognition. The core principle of IFRS 15 is that an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue recognized reflects the transfer of control of the asset to the customer, described as satisfaction of performance obligations. The amount of revenue recognized is equal to the consideration the entity is entitled to for satisfying the performance obligation.

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

The CP categorized revenue transactions into three categories:

Category A – transactions with no performance obligations or stipulations

Category B – transactions with performance obligations or stipulations that do not meet all the requirements of IFRS 15; and

Category C – transactions meet all the requirements of IFRS 15.

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

- (a) The Exchange/Non-Exchange Approach – Update IPSAS 23; and
- (b) A Public Sector Performance Obligation Approach (PSPOA)

Under the Exchange/Non-Exchange Approach – Update IPSAS 23, the current distinction between exchange and non-exchange transactions would be retained as the primary determinant of accounting

treatments for both Category A and Category B transactions. Five options for updating IPSAS 23 are considered to address the issue of making the exchange/non-exchange distinction, and the application issue of timing requirements. Under this approach IPSAS 23 would therefore continue to provide requirements and guidance for both Category B transactions as well as Category A.

The PSPOA would involve adoption of a modified form of the IFRS 15 five-step revenue recognition approach, which reflects the public sector context. In particular, the approach is not restricted to contractual arrangements, but includes binding arrangements and also acknowledges that funding arrangements in the public sector often involve the resource recipient delivering services to a beneficiary, rather than the resource provider.

The IPSASB expresses preliminary views (PV), these are summarized below:

- PV 1 – IPSAS 9 and IPSAS 11 should be replaced with a new IPSAS primarily drawn from IFRS 15.
- PV 2 – Category A revenue transactions do not contain performance obligations or stipulations. These transactions should therefore be addressed in an updated IPSAS 23;
- PV – 3 Category B revenue transactions should be accounted for under a Public Sector Performance Obligation Approach;

The IPSASB has identified capital grants and services-in-kind as other significant application issues with IPSAS 23 and the CP is seeking feedback on these issues. The IPSASB expressed a PV on future guidance for capital grants that:

- PV 4 - Accounting for capital grants should be explicitly addressed within IPSAS;

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

- (a) The Extended Obligating Event Approach; and
- (b) The Public Sector Performance Obligation Approach (PSPOA).

Under The Extended Obligating Event Approach the determinant of whether the transferor of resources has an expense and a liability would be whether there is an obligating event – that is to say an event that creates a legal obligation or non-legally binding obligation that results in the transferring entity having no realistic alternative to settling that obligation. If a liability does exist, for transactions that include stipulations on the resource recipient, then an approach mirroring IPSAS 23 would be used to determine whether expenses related to that liability are recognized immediately or expensed over time.

The IPSASB expresses the following PVs regarding universally accessible services and collective services that

- PV 5 – Non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under an Extended Obligating Event Approach;
- PV 6 – There is no obligating event related to non-exchange transactions for universally accessible services and collective services, therefore resources applied for these types of non-exchange transactions should be expensed as services are delivered.

The PSPOA for non-exchange expenses would be the counterpart to that approach for revenue transactions discussed above. The five-step revenue recognition approach would be reconfigured from the

perspective of the resource provider in order to determine when the resource provider has an expense and a liability as result of a resource recipient satisfying identifiable and specific performance obligations.

The IPSASB has expressed a PV on non-exchange expenses that:

- PV 7 – Grants, contributions and other transfers that contain either performance obligations or stipulations should be accounted for, by the resource provider, using Public Sector Performance Obligation Approach

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

The IPSASB has expressed the following PV that for measurement of non-contractual receivables that:

- PV 8 – Initial measurement of non-contractual receivables should be at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.
- PV 9 – The fair value approach should be used for the subsequent measurement of non-contractual receivables.

REQUEST FOR COMMENTS

This Consultation Paper, *Accounting for Revenue and Non-Exchange Expenses*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Consultation Paper may be modified in light of comments received before being issued in final form. **Comments are requested by January 15 2018.**

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

Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this Consultation Paper, including all Preliminary Views¹ and Specific Matters for Comment. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

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

Preliminary View 1 (following paragraph 3.8)

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

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

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

Preliminary View 2 (following paragraph 3.9)

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

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

Specific Matter for Comment 1 (following paragraph 3.10)

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- (a) Social contributions; and/or
- (b) Taxes with long collection periods.

¹ Where the Board has expressed a Preliminary View, this view has been agreed by at least two thirds of the Board.

If you believe that there are further areas where the IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues that you have encountered, together with an indication of the additional guidance you believe is needed.

Preliminary View 3 (following paragraph 4.64)

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

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

Specific Matter for Comment 2 (following paragraph 4.64)

The IPSASB has proposed broadening the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

Step 1 – Identify the binding arrangement (paragraphs 4.29 - 4.35);

Step 2 – Identify the performance obligation (paragraphs 4.36 - 4.46);

Step 3 – Determine the consideration (paragraphs 4.47 – 4.50);

Step 4 – Allocate the consideration (paragraphs 4.51 – 4.54); and

Step 5 – Recognize revenue (paragraphs 4.55 – 4.58).

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened?

If not, please explain your reasons.

Specific Matter for Comment 3 (following paragraph 4.64)

If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favor for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

(a) Option (b) – Require enhanced display/disclosure;

(b) Option (c) – Classify time requirements as a condition;

(c) Option (d) – Classify transfers with time requirements as other obligations; or

(d) Option (e) - Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.

Please explain your reasons.

Specific Matter for Comment 4 (following paragraph 4.64)

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

(a) Yes

(b) No

Please explain your reasons.

Preliminary View 4 (following paragraph 5.5)

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

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

Specific Matter for Comment 5 (following paragraph 5.5)

- (a) Has the IPSASB identified the main issues with capital grants?
If you think that there are other issues with capital grants, please identify them.
- (b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?
Please explain your issues and proposals.

Specific Matter for Comment 6 (following paragraph 5.9)

Do you consider that the IPSASB should:

- (a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or
- (b) Modify requirements to require services in-kind that meet the definition of an asset to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or
- (c) An alternative approach.

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

Preliminary View 5 (following paragraph 6.37)

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event Approach.

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

Preliminary View 6 (following paragraph 6.39)

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

Preliminary View 7 (following paragraph 6.42)

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons

Preliminary view 8 (following paragraph 7.18)

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

Preliminary View 9 (following paragraph 7.34)

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

Specific Matter for Comment 7 (following paragraph 7.46)

For subsequent measurement of non-contractual payables do you support:

- (a) Cost of Fulfillment Approach;
- (b) Amortized Cost Approach;
- (c) Hybrid Approach; or
- (d) IPSAS 19 requirements?

Please explain your reasons.

ACCOUNTING FOR REVENUE AND NON-EXCHANGE EXPENSES

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1. Chapter 1: Introduction

- 1.1 The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. For decision-making and accountability purposes, users need information on the financial position, financial performance, and cash flows of an entity, as well as information on the:
- Provision of services to constituents;
 - Resources² currently available for future use, including any restrictions or conditions attached to the use of those resources;
 - Burden on future tax-payers for current services; and
 - Changes in the entity's ability to provide services³ compared with the previous period.
- 1.2 The sources of funding for public sector entities include taxation, transfers from other public sector entities, and fees and charges. Public sector entities use these resources to provide services to the public in diverse ways.
- 1.3 The IPSASB has developed a number of International Public Sector Accounting Standards (IPSAS) that address the particular characteristics of public sector entities and their transactions. Through its ongoing work program the IPSASB aims to improve its standards and to develop requirements and guidance on topics not currently addressed by IPSAS. The purpose of this Consultation Paper (CP) is to seek feedback from constituents on a strategic direction for possible improvements to accounting for revenue and for potential requirements and guidance for accounting for non-exchange expenses.

Drivers for this project on Revenue and Non-Exchange Expenses

- 1.4 The IPSASB initiated this project, for which this CP is an intermediate output, in order to develop approaches to address the following areas where information for accountability and decision making needs to be developed or potentially modified:
- (a) The operationalization of the exchange versus non-exchange distinction and the value of that distinction;
 - (b) The gap in the current IPSASB literature on accounting for non-exchange expenses which may lead to ambiguity and inconsistency of accounting policies in a highly significant area of expenditure;
 - (c) Application issues with IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers);
 - (d) Convergence with International Accounting Standards Board (IASB) literature, which has diminished with the publication of International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers* in 2014; and
 - (e) The scope for ensuring a consistency of approaches between resource providers (for non-exchange expense transactions) and resource recipients (for revenue transactions).

² A resource is an item with service potential or the ability to generate economic benefits (see *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* paragraph 5.7)

³ Services, in the public sector, for the purpose of this CP includes goods and services

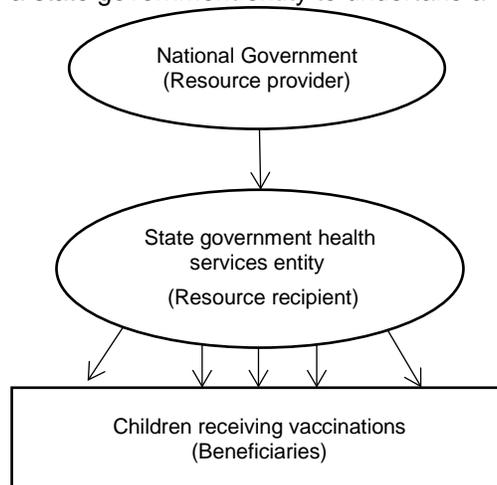
In addition, this project assesses the alignment of the potential approaches with the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (IPSASB Conceptual Framework)*.

- 1.5 The CP addresses accounting for both revenue and non-exchange expense transactions. Various approaches are described and evaluated. An exchange/non-exchange approach based on updating IPSAS 23 and a Public Sector Performance Obligation Approach (PSPOA) (drawn from IFRS 15) are discussed as potential approaches for revenue transactions. For non-exchange expense transactions an extended obligating event approach and a PSPOA are discussed.
- 1.6 Initially two separate projects (Revenue and Non-Exchange Expenses), the IPSASB decided to issue a single CP because the development of separate Consultation Papers would include the duplication of a considerable amount of material, which would be unhelpful to readers. Considering both revenue and non-exchange expense transactions in the same CP facilitates an evaluation of the extent to which the options identified lead to consistent accounting approaches for accounting for revenue and non-exchange expenses.

The Exchange versus Non-Exchange Distinction

- 1.7 IPSAS 23 and other IPSAS require preparers to categorize transactions as exchange or non-exchange. This distinction is embedded in IPSASB literature, as emphasized in the IPSASB *Conceptual Framework*. Most public sector activities are non-commercial in nature and therefore give rise to a large number of non-exchange transactions for which public sector entities do not receive equal, or approximately equal, consideration for services or other resources they provide.⁴ Some arrangements involve three parties: resource providers, resource recipients and beneficiaries. In these tripartite arrangements the resource recipient is not an agent of the resource provider, because the resource recipient gains control of the consideration from the resource provider and is responsible for providing services to the beneficiaries.

The diagram below illustrates an example of a tripartite arrangement whereby a national government provides consideration to a state government entity to undertake a vaccination program.



- 1.8 While preparers have not expressed fundamental disagreement with the distinction between exchange and non-exchange transactions, they have indicated that, at times, there are practical difficulties in making this categorization and that judgments on the categorization can be time-

⁴ The full definition of an exchange and a non-exchange transaction are given in Chapter 2.

consuming. For example in areas like water provision it may be unclear whether a transaction is non-exchange – a tax – or exchange – a fee for a service. They have also questioned whether the separate presentation of information about exchange and non-exchange transactions provides useful information; there is anecdotal evidence that the distinction between exchange and non-exchange transactions reflected in certain disclosures is of limited interest to users. Currently for example, IPSAS 23 requires disclosures on the amount of revenue from non-exchange transactions recognized during the period by major classes.

- 1.9 Furthermore, judgments on whether a transaction is exchange or non-exchange can vary significantly. In particular, there is ambiguity over the meaning of the phrases “approximately equal value” and “directly giving” in the definitions of an “exchange” and a “non-exchange” transaction. The categorization can be particularly difficult for public sector entities that operate under a purchaser-provider model in which they receive funding from another public sector entity to provide goods or services to members of the public. Taken to one extreme, it can be argued that all transactions that a non-commercially-oriented public sector entity enters into are of a non-exchange character. This notion is based on the view that a public sector entity is not involved in activities for its own direct benefit, but, rather, engages in transactions on behalf of its citizens and other constituents. The counterpoint to this argument is the notion that virtually all transactions of a public sector entity are fundamentally exchange in nature. This is because a public sector entity will only enter into transactions in furtherance of its objectives.

Gap in the current IPSASB Literature on Non-Exchange Expenses

- 1.10 While a number of IPSAS provide guidance on the recognition of specific exchange expenses and liabilities⁵, there is very little guidance on the recognition of expenses and liabilities arising from non-exchange transactions, and no equivalent to IPSAS 23, which deals with non-exchange revenue. A consequence is that there is ambiguity and inconsistency in developing accounting policies in a highly significant area of expenditure, including the provision of major services to the community and transfers between different levels of government.
- 1.11 The IPSASB has a current project to develop requirements and guidance for social benefits provided by public sector entities. The IPSASB issued a Consultation Paper, *Recognition and Measurement of Social Benefits*, in July 2015 and after considering the responses an Exposure Draft (ED) of an IPSAS on Social Benefits will be issued later in 2017. While this will be a major development, an IPSAS on Social Benefits will only partially fill the overall “gap” on non-exchange expenses. In fact the development of a narrower definition of “social benefits”⁶, aligned more closely with statistical accounting definitions in comparison with previous IPSASB working definitions, excludes areas such as the universal provision of healthcare and education and therefore makes the development of requirements and guidance for non-exchange expenses not within the definition of social benefits more pressing.

⁵ See for example IPSAS 13, *Leases*, and IPSAS 39, *Employee Benefits*

⁶ Social benefits are provided to:

- (a) Specific individuals and/or households who meet eligibility criteria;
- (b) Mitigate the effect of social risks; and
- (c) Address the needs of society as a whole; but
- (d) Are not universally accessible services.

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

IPSAS 23 Application Issues

- 1.13 IPSAS 23 was issued in December 2006, for application in annual financial statements covering periods beginning on or after June 30th, 2008. Preparers have identified a number of practical issues, in particular:
- (a) Stipulations (the distinction between conditions and restrictions) and particularly time requirements⁷ related to:
 - (i) Multi-year funding
 - (ii) Taxation received in advance of the period in which it is intended to be used
 - (b) Capital grants; and
 - (c) Services in-kind.
- 1.14 Preparers argue that IPSAS 23 is too restrictive in not allowing revenue to be recognized over time when funding is received for a specific purpose, but there is no return obligation. Some preparers also argue that there is a difference between the consumption of resources rather than the more straightforward recognition over time. There is some ambiguity as to the meaning of “over time” and whether recognition should be on a straight line basis or to reflect a more complex pattern of the consumption of resources.
- 1.15 Taxation particularly gives rise to the identification of a taxable event, which can be at a number of points, some of which may be prior to the period for which the tax payment is intended to finance activities. This causes tension between recognizing revenue when the recipient entity gains control of the resources and accruing revenue over the period for which taxation is intended to finance activities. Some international organizations provide resources “pre-financing” activities of counterparties in future reporting periods and consider that they need to reflect such transactions in the statement of financial position.
- 1.16 Capital grants are resources provided to acquire or construct a capital asset. For capital grants there is an issue over how revenue should be recognized. There are a number of potential revenue recognition points – on receipt of consideration, over the course of construction, when construction is completed or over the useful life of the asset. There can also be issues with return obligations where funders specify that a physical asset is used for a particular purpose over its useful life and

⁷ A time requirement is a provision in an agreement indicating the resource provider’s intention that the resources are to be used by the resource recipient in a specific time period or periods. However, there is no explicit return obligation on the resource recipient if the resources are not used in those periods.

there is a requirement that the resources are returned if the asset ceases to be used for that specified purpose.

- 1.17 Services in-kind are highly significant for a number of entities, particularly some international organizations. Currently IPSAS 23 permits, but does not require entities to recognize services-in-kind as an expense (or asset) and revenue. Some take the view that this option impairs comparisons between entities. Chapter 5 discusses capital grants and services in-kind.

Convergence with IASB literature following the issue of IFRS 15

- 1.18 In May 2014 the IASB issued IFRS 15, *Revenue from Contracts with Customers* which replaces IAS 18, *Revenue* and IAS 11, *Construction Contracts* and has an effective date of January 1 2018. IFRS 15 also replaces a number of interpretations⁸. The IPSASB's current standards – IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* – are based on IAS 18 and IAS 11. Therefore the replacement of these standards by IFRS 15 has reduced convergence between the IPSASB's and IASB's literature.
- 1.19 The core principle of IFRS 15 is that an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which that entity expects to be entitled in exchange for the goods and services. Revenue recognized reflects the transfer of control of the asset to the customer. The amount of revenue recognized is equal to the consideration to which the entity expects to be entitled for fulfilling the performance obligation. This performance obligation approach represents new thinking on the recognition of exchange revenue. This new thinking also provides the opportunity to re-evaluate IPSAS requirements and guidance for non-exchange revenue transactions. In particular, it raises the question of whether categorizing transactions according to whether they contain performance obligations is more straightforward than distinguishing between exchange and non-exchange transactions, and then between conditions and restrictions (stipulations) and whether such exchange/non-exchange categorization provides more useful information to users.

Scope and Interaction with Other Projects and Pronouncements

- 1.20 Revenue transactions discussed in this CP are those currently in the scope of IPSAS 9, IPSAS 11 and IPSAS 23.
- 1.21 Non-exchange expense transactions within the scope of this CP are those that are not covered by the scope of the IPSASB's Social Benefits project. Further, transactions that are in the scope of the current IPSASB projects on leases, public sector specific financial instruments, and financial instruments, are also not covered by this CP, as are transactions within the scope of IPSAS 40, *Public Sector Combinations*. Income taxes payable and exchange expense transactions are not covered by this CP.

Consultation Paper Structure

- 1.22 Chapter 2 outlines the current approaches to revenue recognition in the IPSASB's own literature (IPSAS 23, IPSAS 9 and IPSAS 11) as well as the revenue recognition model in IFRS 15.

⁸ These interpretations are SIC 31, *Revenue: Barter Transactions Involving Advertising Services*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for Construction of Real Estate*, and IFRIC 18, *Transfers of Assets from Customers*

- 1.23 Chapter 3 categorizes public sector transactions according to whether they contain performance obligations or stipulations and, if so, whether transactions with performance obligations would be within the scope of a standard based on IFRS 15. The chapter also outlines the IPSASB's approach towards such transactions and to transactions that do not contain performance obligations.
- 1.24 Chapter 4 considers two approaches for recognition of revenue transactions that do not fall within the scope of IFRS 15, but are considered to have performance obligations or stipulations. Approach 1 (5 variations) is based on IPSAS 23 and suggests how it can be updated to address the issues encountered in practice in making the exchange/non-exchange distinction and considering the impact of time requirements. Approach 2, the PSPOA, is based on the IFRS 15 revenue recognition model, but has been adapted for the public sector.
- 1.25 Chapter 5 discusses two other IPSAS 23 application issues – capital grants and services in-kind.
- 1.26 Chapter 6 considers the types of non-exchange expense transactions included in the scope of this CP. It discusses two approaches for recognition of non-exchange expense transactions that are within the scope of this CP. The Extended Obligating Event Approach which is an extension of the recognition approach in the Social Benefits project and the PSPOA which is a mirror of Approach 2 for revenue transactions.
- 1.27 Chapter 7 considers measurement of revenue and non-exchange transactions and other issues related to non-contractual receivables and non-contractual payables and particularly focuses on subsequent measurement.
- 1.28 The Consultation Paper does not consider requirements and guidance related to presentation. The IPSASB will consider presentation⁹ when the component projects reach the Exposure Draft stage.

⁹ The IPSASB *Conceptual Framework* states that presentation is the selection, location and organization of information that is reported in general purpose financial reports. The IPSASB *Conceptual Framework* distinguishes display and disclosure. In the context of the financial statements display relates to the items on the face of the financial statements and disclosure relates to the notes to the financial statements

2. Chapter 2: Current Revenue Recognition Standards

Introduction

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

Definitions

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

Exchange transactions:

"Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange."

Non-exchange transactions:

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

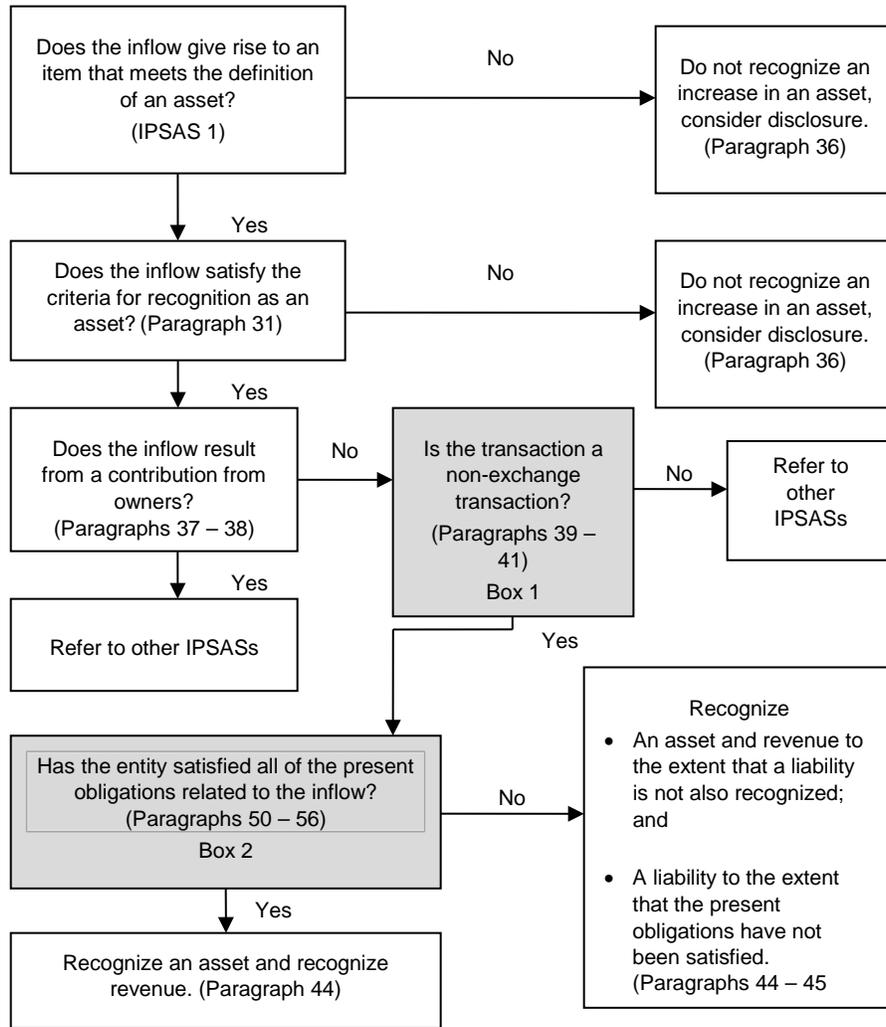
Transactions may include both exchange and non-exchange components.

Non-Exchange Transactions

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

- 2.3 Issued in December 2006, IPSAS 23 prescribes requirements for the financial reporting of revenue from non-exchange transactions, other than non-exchange transactions that give rise to entity public sector combination. IPSAS 23 provides guidance on the identification of contributions from owners but does not provide requirements for their accounting.
- 2.4 IPSAS 23 requires that an inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the transaction (see the diagram below which is taken from IPSAS 23). Therefore, under IPSAS 23, an entity first determines whether an asset should be recognized, based on the inflow meeting the asset definition and recognition criteria. The entity then determines whether there are any liabilities related to the transaction.

Illustration of the Analysis of Initial Inflows of Resources



2.5 As its title indicates, the primary determinant of whether a revenue transaction is within the scope of IPSAS 23 is whether it is exchange or non-exchange in character (see shaded Box 1 in the diagram above). IPSAS 23 acknowledges that there might be transactions that have an exchange or non-exchange component, and groups of transactions that are a combination of exchange and non-exchange transactions. IPSAS 23 uses an illustrative example of funding from a multi-lateral development agency that includes a grant and a concessionary loan with market and off-market components. Accounting for the exchange component of a transaction, or exchange transactions within a broader group of transactions, will be in accordance with another IPSAS. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.

2.6 IPSAS 23's definition of stipulations on transferred assets (hereafter stipulations), and the sub-categorization of stipulations into restrictions on transferred assets (hereafter restrictions) and conditions on transferred assets (hereafter conditions), is central in determining whether the entity has satisfied all the present obligations related to an inflow (shaded Box 2 in the diagram above) or instead the transaction, or group of transactions, gives rise to liabilities.

- 2.7 IPSAS 23 defines stipulations as “terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity”. The two sub-categories of stipulation (conditions and restrictions) are defined as following:
- (a) Conditions [on transferred assets] are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.
 - (b) Restrictions [on transferred assets] are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.
- 2.8 Therefore, because conditions require the entity to return the resources to the transferor if those conditions are not fulfilled, the resource recipient initially recognizes an asset that is subject to a condition, and a liability because there is a present obligation (to the resource provider) to transfer economic benefits or service potential to a beneficiary. As the entity satisfies the conditions related to the inflow of resources it reduces the carrying amount of the liability and recognizes revenue equal to the amount of the reduction.
- 2.9 Because restrictions do not specify that resources have to be returned to the transferor if they are not used as specified, a recipient of resources with restrictions, but no conditions, does not recognize a liability, but recognizes revenue as the gross amount of the inflow of resources. IPSAS 23 acknowledges that where there are breaches of restrictions, the transferor, or another party, may have the option of seeking a penalty against the recipient by legal or administrative processes. Such actions may result in a direction that the entity fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. However, IPSAS 23 explains that any such penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.
- 2.10 IPSAS 23 includes the following measurement requirements:
- (a) An asset acquired through a non-exchange transaction is initially measured at fair value at the date of its acquisition;
 - (b) A liability related to a condition(s) on a transferred asset is measured at the best estimate of the amount required to settle the present obligation at the reporting date; and
 - (c) Revenue from non-exchange transactions is measured at the amount of the net increase in net assets recognized by the entity.
- 2.11 IPSAS 23 includes high level and separate guidance on revenue recognition for taxes and transfers, the two most significant sources of non-exchange revenue for many governments and other public sector entities. For taxes IPSAS 23 defines the taxable event as the “event that the government, legislature, or other authority, has determined will be subject to taxation.” The taxable event is the point at which an asset in respect of taxes is recognized if recognition criteria are met. IPSAS 23 provides high level guidance on the taxable event for a number of types of tax¹⁰, noting that it is essential for preparers to analyze the taxation law in their jurisdictions to determine the taxable event. IPSAS 23 acknowledges the following examples of transfers – grants, debt forgiveness, fines, bequests, gifts, donations and goods and services¹¹ in-kind – and provides commentary on each.

¹⁰ Income tax, value-added tax, good and services tax, customs duty, death duty and property tax.

¹¹ From here on in, ‘goods and services’ in the public sector are just called ‘services’

- 2.12 IPSAS 23 does not provide requirements or guidance on measurement subsequent to initial recognition. Chapter 7 of this CP discusses subsequent measurement and also considers measurement at initial recognition in more detail.

Exchange Transactions

IPSAS 9, Revenue from Exchange Transactions

- 2.13 IPSAS 9, *Revenue from Exchange Transactions*, was issued in July 2001. IPSAS 9 provides specific requirements and guidance on the recognition of revenue from the sale of goods, rendering of services, and the use by others of entity assets yielding interest, royalties, and dividends or similar distributions. Recognition of revenue is based on the following principles:

- (a) **Rendering of services:** stage of completion.
- (b) **Sale of goods and services:** the risk and rewards of ownership of the goods.
- (c) **Interest:** a time proportion basis taking into account the effective yield on the asset.
- (d) **Royalties:** as earned in accordance with the substance of the relevant agreement.
- (e) **Dividends or similar distributions;** when the shareholder's or entity's right to receive payment is established.

- 2.14 Revenue is measured at the fair value of the consideration received or receivable.

- 2.15 IPSAS 9 is primarily drawn from IAS 18, *Revenue*. While there are differences in terminology and some additional commentary in IPSAS 9, the only significant substantive difference is that the definition of revenue adopted in IPSAS 9 does not include a reference to ordinary activities – this reflects a view that it is not straightforward to determine what an ordinary activity is in the public sector, particularly for multi-functional entities. The accounting treatments in the two standards are the same. IAS 18 will be replaced by IFRS 15 for accounting periods after January 1, 2018.

IPSAS 11, Construction Contracts

- 2.16 IPSAS 11, *Construction Contracts*, was also issued in July 2001. IPSAS 11, which was primarily drawn from IAS 11, *Construction Contracts*, prescribes the accounting treatment of costs and revenue associated with construction contracts in the financial statements of the contractor.

- 2.17 IPSAS 11 provides a definition of construction contracts and requirements and guidance on the allocation of contract revenue and contract costs to accounting periods in which construction work is performed. Recognition of contract revenue and expense is based on the “stage or percentage of completion” approach when the outcome of the construction contract can be estimated reliably. If such an outcome cannot be estimated reliably, revenue is recognized only to the extent of recoverable contract costs.

- 2.18 IPSAS 11 defines a construction contract, provides further definitions of “a cost plus or a cost-based contract”, a “fixed price contract” and a “contractor” and prescribes the accounting treatment of costs and revenue associated with construction contracts.

- 2.19 In addition to differences of terminology IPSAS 11 includes modifications to reflect the fact that, in the public sector, construction contracts may be on a non-commercial basis. For example, the IAS 11 definition of a “cost plus contract” is modified to include “cost-based contracts”, with no profit margin. Implementation guidance explains how the cost of completion approach is applied to non-commercial contracts. IPSAS 11 also acknowledges that arrangements can involve three parties with the third

party providing funding and that, where consideration in excess of that specified in the construction contract will be provided from an appropriation or other third party source, it is not necessary to recognize an expected deficit as an immediate expense. IAS 11 will be replaced by IFRS 15 for accounting periods after January 1, 2018.

IASB Literature

IFRS 15, Revenue from Contracts with Customers

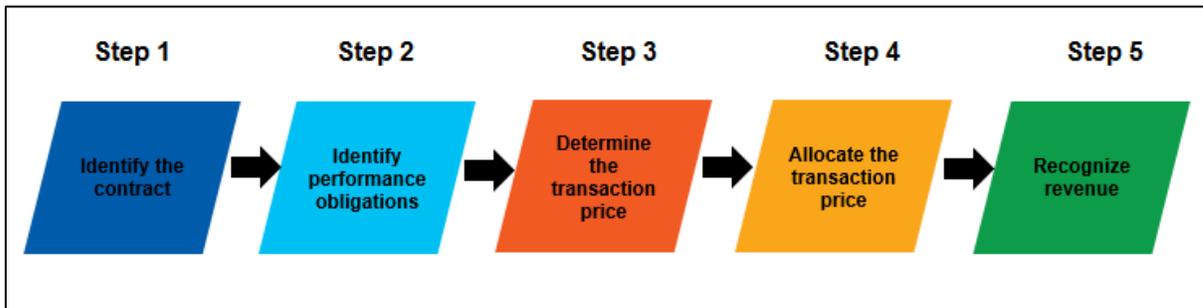
2.20 IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014. In September 2015 the IASB deferred the effective date by a year to January 1, 2018 and in April 2016 the IASB issued *Clarifications to IFRS 15, Revenue from Contracts with Customers*, which provided clarifying amendments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

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

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

2.22 These core principles are explained in a five-step revenue recognition model. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to the customer at the amount to which the entity expects to be entitled. The five-step revenue model is important, not simply for a converged version of IFRS 15, but also for the potential Public Sector Performance Obligation Approach (discussed in Chapter 3), for which it provides the principles. The model is presented diagrammatically below and then the five steps are discussed.

Five-step revenue recognition model



- (a) **Step 1: Identify the contract with the customer** – a contract is an agreement between two or more parties that creates enforceable rights and obligations.

The scope of IFRS 15 is limited to contracts with customers when all of the following criteria are met:

- (i) The parties to the contract have approved the contract and are committed to perform their respective duties;
- (ii) Rights to goods and services to be transferred and payment terms can be identified;
- (iii) The contract has commercial substance; and

(iv) Collection of consideration is probable.

- (b) **Step 2: Identify the performance obligations in the contract** – these are promises in a contract to transfer *distinct* goods or services to a customer.

If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.

- (c) **Step 3: Determine the transaction price** – the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of consideration, but it may sometimes include variable consideration (which requires estimation when highly probable) and non-cash consideration. Discounting for the time value of money may be required.
- (d) **Step 4: Allocate the transaction price to the performance obligations in the contract** – an entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. This step takes account of discounts and variable consideration.
- (e) **Step 5: Recognize revenue when (or as) the entity satisfies the performance obligation** – an entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

2.23 Compared with IAS 18, under IFRS 15 an entity recognizes revenue when (or as) it satisfies performance obligations. The timing of payment does not generally affect the recognition of revenue. Revenue recognition can occur before or after the entity receives payment, or is entitled to payment. If an entity satisfies a performance obligation before it is entitled to payment it recognizes a contract asset. When the entity becomes entitled to payment, it recognizes a receivable.

2.24 An underlying principle of the revenue recognition model in IFRS 15 is that revenue is not recognized until control of the promised goods or services is transferred to the customer. The concept of transferring control in a revenue transaction is more easily envisaged for the sale of goods (described as transferring control of assets). However, the performance obligation approach treats both goods and services as assets (even if only temporarily). Control of services rendered are transferred to the customer when the customer obtains the benefits of those services or the ability to direct the use of those benefits.

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

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

2.26 IFRS 15 allows for the recognition of revenue over time, if one of the following criteria is met:

- (a) The customer simultaneously receives and consumes the benefits provided as the performance obligations are performed;
 - (b) The entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
 - (c) The entity's performance does not create an asset with an alternative use to the entity but the entity has an enforceable right to payment for performance completed to date.
- 2.27 For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.
- 2.28 If an entity does not satisfy the IFRS 15 criteria to recognize revenue over time, revenue is then recognized at a point in time. This can result in revenue not being recognized in a contract delivered over multiple periods until the promised goods or services are fully completed and control has been transferred to the customer.
- 2.29 When performance obligations are satisfied at a point in time, an entity is required to form a judgement as to when control of the goods or services is transferred to the customer. The indicators in IFRS 15 for determining the transfer of control at a point in time include (but are not limited to):
- (a) The entity has a present right to payment for the asset;
 - (b) The customer has legal title;
 - (c) The entity has transferred physical possession to the customer;
 - (d) The customer has significant risks and rewards of the ownership of the asset; or
 - (e) The customer has accepted the asset.
- 2.30 IFRS 15 contains application guidance on whether an entity arranging for the provision of goods or services by another party is a principal or an agent. Subject to qualifications on very temporary control, the high level test is whether the entity controls a promised good or service before the entity transfers that good or service to a customer. This is complemented by a series of illustrative indicators that an entity is an agent, such as that another party is primarily responsible for fulfilling the contract, the entity does not have discretion in pricing, the entity's consideration is in the form of a commission and the entity is not exposed to credit risk.
- 2.31 In summary, the main characteristics of a revenue transaction within the scope of IFRS 15 are:
- (a) There has to be a customer who receives the benefits of delivered goods or services, described as the satisfaction of performance obligations;
 - (b) The performance obligations can be identified;
 - (c) The promised goods or services are specified in sufficient detail to enable the satisfaction of performance obligations to be determined;
 - (d) The performance obligations are established through a legal contract, which creates enforceable rights and obligations between the parties;
 - (e) The contract has commercial substance;
 - (f) Control of the promised goods or services is transferred to the customer;
 - (g) The transaction price can be allocated to the performance obligations in the contract; and

ACCOUNTING FOR REVENUE AND NON-EXCHANGE TRANSACTIONS

- (h) Revenue is recognized by reference to when (or as) control of the promised goods or services are transferred to the customer.
- 2.32 Chapter 3 categorizes public sector transactions into three broad categories (A, B and C) dependent on the extent and nature of performance obligations in the transaction and makes proposals for:
- (a) Category A – transactions which do not contain any performance obligations or stipulations ;
 - (b) Category C – transactions that are within the scope of IFRS 15; and
 - (c) Category B – transactions which do not fall within Category A or Category C.
- 2.33 Chapter 4 discusses two possible approaches for recognition of Category B revenue transactions;
- (a) Approach 1 – The Exchange/Non-Exchange Approach – Update IPSAS 23; and
 - (b) Approach 2 – The Public Sector Performance Obligation Approach which broadens the IFRS 15 requirements to suit public sector transactions.
- 2.34 Chapter 5 discusses two areas where issues have arisen with the application of IPSAS 23 – accounting for capital grants and services in-kind.

3. Chapter 3: Analyzing Public Sector Transactions with Reference to Performance Obligations

- 3.1 This Chapter introduces three broad categories of public sector revenue and non-exchange expense transactions based on whether such transactions include performance obligations as defined in IFRS 15 or stipulations as defined in IPSAS 23, or in another form. These categories have been developed to allow further consideration of the approaches described in this CP, in particular the extent to which a performance obligation approach can be applied to public sector transactions. The categorization simplifies the real world. In practice, there is likely to be a spectrum of transactions – at one end transactions with no performance obligations, at the other end transactions with identifiable and enforceable performance obligations. Many transactions lie somewhere in between. Despite these limitations, the categories are useful in facilitating an evaluation of the extent to which a performance obligation approach could be applied to public sector transactions.
- 3.2 The chapter concludes by providing potential approaches for two of these categories – Category C and Category A transactions. The possible approaches for Category B transactions are considered in subsequent chapters.
- 3.3 The IPSASB has categorized transactions as follows:
- (a) Category A – Revenue and non-exchange expense transactions with no performance obligations or stipulations. For example, general taxation receipts and inter-governmental transfers, such as non-specific and non-earmarked grants. Such grants may be provided to finance activities of an entity where the entity has complete discretion over how and when a grant is used.
 - (b) Category B – Revenue and non-exchange expense transactions that contain performance obligations or stipulations, but do not have all the characteristics of a transaction within the scope of IFRS 15.
 - (c) Category C – Revenue transactions that are within the scope of IFRS 15. This category includes transactions involving the transfer of promised goods or services to customers as defined in IFRS 15. The key characteristic of a Category C transaction is that there is a contract with a customer which establishes performance obligations.

The diagram below illustrates the categorization of transactions.

Categorization of Revenue Transactions			
Current	Non-Exchange		Exchange
CP Revenue	Category A	Category B*	Category C
Characteristic	No performance obligations or stipulations	Enforceable agreements, with performance obligations or stipulations to use or consume resources in a particular way; and/or other agreements requiring resources to be used over a specified period of time	Enforceable agreements, with performance obligations to transfer goods or services to customers on commercial terms
Examples	Taxes, transfers	Funding to deliver a specified number of vaccinations to the public	Sale of goods or services on commercial terms

* Whether Category B transactions are considered to be exchange or non-exchange can differ depending on how the characteristics of the transaction are interpreted.

Approach to Category C Revenue Transactions

- 3.4 The IPSASB has an objective of convergence with IASB Standards, where appropriate. Therefore, for revenue transactions in the public sector, which are similar in nature and substance to for-profit revenue transactions, the IPSASB considers that the standards-level requirements and guidance of the IPSASB and IASB should be converged and provide the same outcomes.
- 3.5 The definition of revenue in the IPSASB *Conceptual Framework* is “Increases in the net financial position of the entity, other than increases arising from ownership contributions”. The IPSASB considers that the definition of income in IFRS 15 is consistent with this definition.
- 3.6 The IPSASB is of the view that the quality of accounting for transactions currently addressed in IPSAS 9 and IPSAS 11 will be enhanced by development of a new IPSAS, primarily drawn from IFRS 15. A converged approach is also considered to be more efficient for consolidation purposes in jurisdictions where commercially-oriented public sector entities report on an IFRS-basis.
- 3.7 The development of standards-level requirements and guidance converged with IFRS 15, for the purpose of application to Category C transactions, will require modification to allow the approach to be applied to public sector transactions. The IPSASB considers the extent of the modifications will be generally limited to changes of terminology rather than substance. In developing an IPSAS based on IFRS 15 to deal with Category C transactions the IPSASB will apply *The Process for Modifying IASB Documents* (also known as the Rules of the Road).
- 3.8 Modifications in developing an IPSAS primarily drawn from IFRS 15 may include:
 - (a) Modifying the IFRS 15 definition of “revenue” to ensure consistency with the IPSASB *Conceptual Framework* definition, including the removal of references to “ordinary activities.”

The current IPSASB literature does not generally make a distinction between ordinary activities and activities outside the ordinary course of operations, primarily because of the multi-functional nature of many public sector entities;

- (b) Modifying the recognition requirements for expenses arising from construction contracts where there are third party funding arrangements such as those acknowledged in IPSAS 11;
- (c) Guidance to distinguish between inflows related to revenue transactions arising from the satisfaction of performance obligations and ownership contributions; and
- (d) Acknowledgement that rights and obligations are not only established through legal contracts, but can also be established through equivalent enforceable binding arrangements.

Preliminary View 1

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

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

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

Approach to Category A Revenue Transactions

3.9 As Category A transactions do not contain any performance obligations or stipulations an approach to their accounting based on the identification and fulfillment of performance obligations or stipulations is obviously impractical. Requirements and guidance for Category A revenue transactions will be provided in an updated IPSAS 23.

Preliminary View 2

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

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

3.10 Constituents have encountered a number of issues in applying IPSAS 23 where further clarification or guidance is required which the IPSASB plans to address when IPSAS 23 is updated. As well as capital grants and services in-kind these include the applicability of IPSAS 23 to accounting for social contributions¹², and approaches to accounting for taxes with long collection periods – that is tax revenue which is received over multiple reporting periods. The IPSASB is keen to receive feedback on the problems encountered in these and other areas.

Specific Matter for Comment 1

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- (a) Social contributions; and/or

¹² Social contributions are contributions or levies, paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks, to finance a specific social benefit scheme, and where the contributions or levies received are restricted to providing that social benefit.

(b) Taxes with long collection periods.

If you believe that there are other areas where the IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues that you have encountered, together with an indication of the additional guidance you believe is needed.

Approach to Category B Transactions

3.11 Chapter 4 considers two possible approaches for dealing with Category B transactions – an Exchange/Non-Exchange Approach with an updated IPSAS 23; and broadening the five steps in IFRS 15 to encompass some or all of Category B transactions through the development of a Public Sector Performance Obligation Approach.

4. Chapter 4 – Revenue Transactions (Category B) – Recognition Approaches

Introduction

- 4.1 This chapter discusses possible recognition approaches for Category B revenue transactions – that is transactions that contain performance obligations or stipulations, but do not have all the characteristics required by IFRS 15.
- 4.2 The simplest way to address Category B revenue transactions might be to retain IPSAS 23 in its current form. This is based on the view that the requirements in IPSAS 23 were developed on conceptually sound principles. However, this would not resolve the issues identified such as difficulties with exchange/non-exchange classifications, stipulations – conditions vs restrictions, time requirements, capital grants and services in-kind. This chapter discusses five possible options for updating IPSAS 23, primarily to address the issues of ambiguity in making the exchange/non-exchange determination and concerns about the accounting outcomes for transactions with time requirements.¹³
- 4.3 This chapter also considers a second approach, where the IFRS 15 five-step revenue recognition approach could be adapted for use in the public sector as an alternative way to address these issues. The chapter concludes by providing matrices of the advantages and disadvantage of each approach (and their variants) against common factors.

Approach 1 – The Exchange/Non-Exchange Approach – Update IPSAS 23

- 4.4 As its name indicates, under an exchange/non-exchange approach the current distinction between exchange and non-exchange transactions would be retained as the primary determinant of accounting treatments. Therefore, IPSAS 23 would continue to provide requirements and guidance for both Category A and B transactions – that is, revenue transactions classified as non-exchange.
- 4.5 The following section addresses issues associated with stipulations: conditions and restrictions and, in particular, time requirements (see shaded box 2 in the diagram following paragraph 2.4).

Stipulations: Conditions and Restrictions

- 4.6 IPSAS 23 defines stipulations and sub-categorizes stipulations into conditions and restrictions. As already noted some preparers find this approach inflexible, particularly in relation to the treatment of transfers with time requirements.

Time Requirements

- 4.7 Currently time requirement stipulations are classified as restrictions rather than conditions. This is because IPSAS 23 requires the recipients of transferred resources to recognize both an asset and revenue unless an agreement contains conditions – that is to say, there is both an obligation for resources to be used or consumed for a particular purpose and a return obligation. Therefore, resources transferred without conditions prior to the reporting period for which they are intended to be used (i.e., those with just time requirements) give rise to revenue at the point at which they are receivable and the recipient controls those resources. Some preparers think that IPSAS 23 gives rise

¹³ A time requirement is a provision in an agreement indicating the resource provider's intention that the resources are to be used by the resource recipient in a specific time period or periods. However, there is no explicit return obligation on the resource recipient if the resources are not used in those periods

to accounting outcomes that do not present relevant and faithfully representative information or information that is understandable and promotes inter-entity comparisons.

4.8 The transactions that may be affected by this requirement include some of the most important resources that public sector entities receive to finance their activities – inter-governmental transfers, taxation receipts and general multi-year grants. Consequently, unless there is an obligation to return the resources if they are not used in a manner specified by the resource provider, resources received in advance of the period for which they are intended to be used and controlled by the recipient are recognized when they are receivable. The result is that, for example, the resources from a five-year grant without conditions are recognized as revenue in the reporting period in which that consideration is receivable, regardless of when the costs related to the five-year grant may be incurred.

4.9 The IPSASB has identified the following five possible options to addressing these issues:

To address the exchange/non-exchange determination issue:

Option (a) - Provide additional guidance on making the exchange/non-exchange distinction;

To address transfers with time requirements;

Option (b) - Require enhanced display/disclosure;

Option (c) - Classify time requirements as a condition;

Option (d) - Classify transfers with time requirements as “other obligations”; and/or

Option (e) - Recognize a transfer with time requirements in net assets/equity and recycle through statement of financial performance.

Each approach is summarized in turn below.

4.10 Appendix A to this CP details the advantages and disadvantages for each approach considered against the following common factors:

- (a) Is consistent with the IPSASB Conceptual Framework;
- (b) Is consistent with other IPSAS;
- (c) Resolves the difficulty with the exchange/non-exchange determination for certain revenue transactions; and
- (d) Enables recognition of revenue over time for transactions with time requirements (if applicable).

Option (a) – Provide additional guidance on making the exchange/non-exchange distinction

4.11 The IPSASB considers that the main issue in making the exchange/non-exchange distinction lies in the definitions of exchange and non-exchange¹⁴ and the difficulty with assessing what is meant by

¹⁴ An exchange transaction is defined as:

Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, good, services, or use of assets) to another entity in exchange.

A non-exchange transaction is defined 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.

“directly giving” and “approximately equal value” (see paragraph 1.9). Therefore, to address this issue additional guidance would be added to IPSAS 23 specifically addressing these terms.

- 4.12 This CP does not provide a draft of such guidance. The IPSASB considers that additional guidance might go some way to solving this issue but acknowledges that entities could still have to apply judgement in making this assessment. Therefore, it might not solve the problem completely. Also any guidance provided would require entities to reassess how the exchange/non-exchange distinction is currently being applied and might result in changes to current practices.
- 4.13 One major disadvantage of only providing additional guidance on making the exchange/non-exchange distinction is that it would not address the issue of immediate revenue recognition for transfers with time requirements as the only stipulation. However, Option (a) could be used in combination with the following four options which address the time requirement issue.

Option (b) – Require enhanced display/disclosure for transactions with time requirements

- 4.14 One option is to use presentational means¹⁵ to indicate the resource provider’s intention as to how a transfer is used. These might include one or both of the following:
- (a) Note disclosures explaining that resources within accumulated surplus or deficit include resources that the resource provider intends for use by the resource recipient in one or more future reporting periods¹⁶; and/or
 - (b) Disaggregation of revenue in the statement of financial performance and net financial position (net assets/equity) to identify resources that the resource provider intends to be used by the resource recipient in future years.
- 4.15 Under subparagraphs (a) and (b) in paragraph 4.14, revenue from funding agreements with time requirements, but no conditions would continue to be recognized in the statement of financial performance when receivable, with further information being provided through a note disclosure to that statement and/or a line item in the statement of changes in net assets/equity.
- 4.16 For example, under (a) in paragraph 4.14 the notes to the accounts could read as follows:

Note Disclosure:
 Accumulated surplus and deficit is CU500,000. Of this, CU100,000 is restricted for use in year XX - XX

- 4.17 Alternatively, under (b) in paragraph 4.14, the statement of financial performance could have revenue displayed as follows:

¹⁵ Other national standard-setters have taken this approach whereby entities are encouraged (but not required) to disclose information about externally imposed restrictions that limit or direct the purpose for which resources controlled by the entity may be used.

¹⁶ IPSAS 23 paragraph 106(d) already requires the disclosure of the amount of assets recognized that are subject to restrictions and the nature of those restrictions.

Revenue receivable – restricted (for use in XX - XX)	100,000*
Revenue received – unrestricted	200,000
Total revenue	300,000

* This disaggregated information would flow through to accumulated surplus/deficit under net assets/equity in the statement of changes in net assets/equity.

- 4.18 Those who support these methods consider that they preserve the integrity of the financial statements by only recognizing items that meet the definition of an element while providing users with the information that they need for accountability and decision-making purposes. However, others think that presentational approaches do not indicate clearly that transactions, such as multi-year year grants, are intended to finance activities for periods beyond the reporting period in which they are recognized. Therefore, they do not address the reservations noted in paragraph 4.7. Further, maintaining a register of transactions with time requirements could be onerous.

Option (c) – Classify time requirements as a condition

- 4.19 Superficially the most straightforward solution to facilitate the recognition of revenue over a period of time would be to reclassify time requirements as conditions, so that such requirements are deemed to give rise to a liability of the recipient until the reporting period in which the resource provider intended the resources to be utilized by the resource recipient. This option would involve modifying the definition of a condition on a transferred asset, so that it specifically included time requirements. However, there would be no return obligation, so the resulting “liability” would be inconsistent with IPSASB’s broader literature, resulting in obligations being recognized as liabilities that would be unlikely to meet the liability definition in the IPSASB *Conceptual Framework*.¹⁷ Therefore, the IPSASB has strong reservations about simply reclassifying time requirements as conditions.

Option (d) Classify transfers with time requirements as other obligations

- 4.20 In the development of its Public Sector Conceptual Framework the IPSASB issued Exposure Draft (ED), *Elements and Recognition in Financial Statements*, which proposed that deferred inflows and deferred outflows should be adopted as elements. The objective at that time was largely to address the issue of time requirements. The ED proposed that entities which receive resources in non-exchange transactions for use in specified future reporting periods would recognize a deferred inflow, while entities that provide resources in non-exchange transactions for use in specified future reporting periods would recognize a deferred outflow. In proposing deferred inflows and deferred outflows as elements the IPSASB considered it was important for preparers accounting for certain non-exchange transactions to be able to distinguish flows relating to different reporting periods.
- 4.21 Following consultation on that ED the IPSASB decided not to define deferred inflows and deferred outflows as elements. However, in the finalized IPSASB *Conceptual Framework* the IPSASB did accept that “certain economic phenomena that do not meet the definition of any element may need to be recognized in the financial statements in order to meet the objectives of financial reporting.”¹⁸ The IPSASB believed that using this option met the objectives of financial reporting because “the circumstances under which other obligations and other resources will be recognized will be

¹⁷ The definition of a liability in the IPSASB’s Conceptual Framework is: A present obligation of the entity for an outflow of resources that results from a past event.

¹⁸ IPSASB *Conceptual Framework*, Chapter 5 paragraphs 5.27-5.28

determined at the standards level and explained in the Bases for Conclusions of specific standards.” At the time of approval of this CP, other resources and other obligations have not been used at a standards-level.

- 4.22 In introducing other resources and other obligations in the IPSASB *Conceptual Framework*, the IPSASB was balancing polarized views of constituents, between those who argued these items were not conceptually supportable as elements and those who argued that displaying these items would better meet the perceived needs of users for information about flows relating to particular reporting periods.
- 4.23 One option would therefore be to accept that the receipt of resources with time requirements and no conditions do not give rise to a liability of the recipient, but that it is in the public interest for the recipient to recognize an “other obligation” – this would convey to users of the financial statements that the recipient had resources that were intended for use in subsequent reporting periods. The resource recipient would recognize revenue and a reduction of the “other obligation” in the period when the resource provider intended the resource to be used.

Option (e) Recognize transfers with time requirements in net assets/equity and recycle through statement of financial performance

- 4.24 The final option to update IPSAS 23 would be to take transfers with time requirements directly to net financial position (net assets/equity) through the statement of changes in net assets/equity when receivable and recycle them to surplus/deficit via the statement of financial performance in the time period in which the resource provider intended them to be used by the resource recipient. This is an option because the IPSASB *Conceptual Framework* does not restrict the recognition of elements to any particular financial statement. However, some argue that this option would implicitly introduce the notion of “other comprehensive income” into the IPSASB literature without exploring the conceptual basis for doing so. During the development of the IPSASB *Conceptual Framework* a number of reservations were expressed about adopting the notion of other comprehensive income, largely because principles for its use were difficult to identify.

Approach 2 – The Public Sector Performance Obligation Approach for Revenue

- 4.25 An alternative approach to updating IPSAS 23 for the exchange/non-exchange approaches would be to focus on whether arrangements have performance obligations rather than whether they have stipulations. This approach would draw on the IFRS 15 performance obligation approach. However, the IFRS 15 approach was developed for commercial transactions. Therefore, developing a performance obligation approach for a public sector environment would require broadening the five-step revenue recognition approach in IFRS 15 and might give rise to a number of challenges.
- 4.26 For example, a public sector revenue transaction, in contrast to a private sector for-profit transaction, may have:
- (a) Less detail on the specifications of the goods or services (hereafter services when referring to the public sector) to be supplied;
 - (b) Three parties involved instead of one supplier and one customer (as illustrated in Chapter 1). Entities may receive consideration from one party to provide services to another party – resource provider, resource recipient and beneficiary. While IFRS 15 does envisage such circumstances – for example where flowers are delivered to a third party rather than to the

individual paying for them – the volume and scale of such transactions is far greater in the public sector;

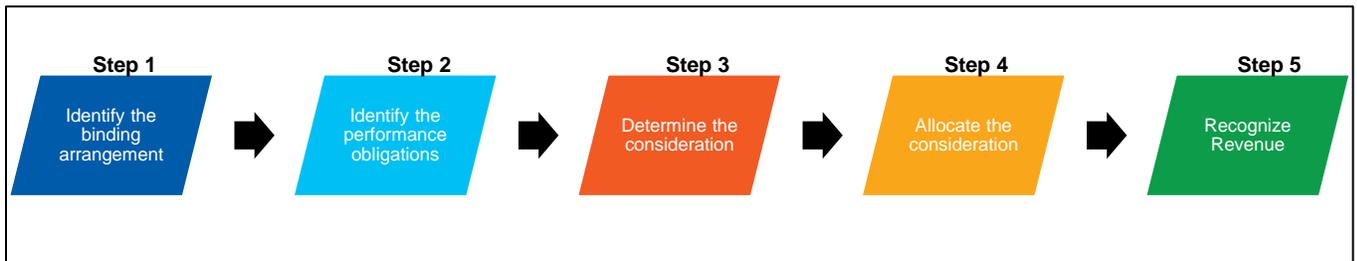
- (c) Less clarity over when control of services has been transferred to another entity or individual; or
- (d) More variation and uncertainty about enforceability. This is because many agreements will not be legal contracts. Consequently there may be less detail in the agreement on enforcement mechanisms.

4.27 The development of a performance obligation approach for the public sector would mean that the current distinction between exchange and non-exchange transactions as the primary determination of accounting treatment for many transactions would be replaced with a distinction between arrangements with performance obligations and those without performance obligations. Under this approach IPSAS 23 would be retained in an updated form for Category A transactions.

The Five-Step Revenue Recognition Approach in a Public Sector Context

4.28 The CP retains the five-step IFRS 15 revenue recognition approach as the basis of developing the PSPOA. For each of the five steps, the IFRS 15 characteristic is described, then, the public sector characteristics that would need to be taken into account in order to broaden the five steps to develop the PSPOA are discussed.

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



Step 1 Identify the binding arrangement

IFRS 15 characteristic

4.29 The first step in the five-step revenue recognition model in IFRS 15, is “the entity identifies the contract with the customer”. Because IFRS 15 deals with contractual arrangements, enforceability will be effected through commercial law in a particular jurisdiction, which is likely to be the law of contract (or equivalent). The Basis for Conclusions of IFRS 15 acknowledges that certain contractual terms may be implied through business practice rather than explicit terms.¹⁹ However, acknowledging an implied term does not negate the fundamental point that arrangements within the scope of IFRS 15 are enforceable, that is, both parties to the contract have legal redress in the event of a breach.

4.30 IFRS 15 requires the identification of the customer in each contractual arrangement. This is a key step in the IFRS 15 approach because revenue is not recognized until control of promised goods or

¹⁹ See paragraphs BC35 and BC87 of IFRS 15

services is transferred to the customer. IFRS 15 provides that a performance obligation approach is only appropriate when a contract explicitly states the goods or services an entity has promised to transfer to a customer (the performance obligations). Performance obligations can only be enforced when each party has agreed to the promised goods or services to be delivered.

Step 1 broadened for the public sector

- 4.31 In the public sector many arrangements for the provision of resources are non-contractual, so a first step that solely focused on contracts would be of limited value. Furthermore, the IPSASB *Conceptual Framework* acknowledges that “There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework.”²⁰ For this reason and the fact that, as noted in paragraph 3.8(d), many binding agreements are established through means other than legal contracts, this first step would need to be relabeled “Identify the binding arrangement”
- 4.32 The IPSASB considers that enforceability in a binding arrangement would be an important aspect of any approach based on the fulfillment of performance obligations and that it is questionable whether performance obligations that are not enforceable have substance. For this reason, the IPSASB takes the view that the interpretation of enforceability would need to go beyond an obligation of the resource recipient to return resources directly to the resource provider (as in IPSAS 23), and include all situations where the transferor of resources is able to take remedies in the event of non-fulfillment of a performance obligation. The IPSASB considers this reflects the public sector context of arrangements, and that enforceability can be reflected by a range of non-contractual mechanisms, such as legislation, cabinet and ministerial decisions, and reductions of future funding for the same program.
- 4.33 In assessing enforceability the emphasis would need to be on the ability of the resource provider to take remedies in the event of non-fulfillment of a performance obligation, rather than an overemphasis on the past record of enforcement. Enforceability would not extend to reputational risk.
- 4.34 The nature of transactions in the public sector sometimes means that it may not be obvious who the customer²¹ is in an arrangement. This is because, as discussed earlier, public sector transactions often involve three parties – the resource provider which provides the consideration, the resource recipient, which receives the consideration and is responsible for the delivery of services, and the beneficiary of those services, which can be individuals or households. In public sector transactions the customer is the entity that has entered into a binding arrangement to fund the delivery of services – that is the resource provider. Even though the resource provider will often not directly receive the services in the performance obligation the resource provider receives the benefits of fulfilled performance obligations delivered to third parties (beneficiaries). This is because the resource provider has the ability to direct who receives services in those performance obligations, and provision of the services is in accordance with the resource provider’s objectives.
- 4.35 As with IFRS 15 transactions there may be a question whether the entity providing the services is acting as an agent, rather than a principal. This determination would need to be clarified when

²⁰ IPSASB Conceptual Framework paragraph 5.20

²¹ The term ‘customer’ can be problematic in the public sector. However, the term ‘customer’ is used in this CP to avoid different terminology.

developing a PSPOA. Some of the indicators highlighted in paragraph 2.29 might be relevant to such a determination.

Step 2 Identify the performance obligations

IFRS 15 characteristic

4.36 IFRS 15 requires the identification of “distinct” good and services, to enable the determination of when a performance obligation has been satisfied. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

4.37 A performance obligation is defined as:

A promise in a contract with a customer to transfer to the customer either:

- (a) A good or service (or a bundle of goods or services) that is distinct; or
- (b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

4.38 The objective of identifying each distinct good and service in a contract with a customer is to determine whether an entity’s promise to transfer that good or service is separately identifiable from other promises in the contract, and should therefore be accounted for separately.

Step 2 broadened for the public sector

4.39 IFRS 15 is based on identifying whether promises to deliver goods and services to customers are distinct to enable a determination of when a performance obligation has been fulfilled. In broadening this concept for a PSPOA, the IPSASB would need to consider when promises to deliver services in the public sector are considered distinct in a binding arrangement to enable identification of performance obligations and to assess when performance obligations have been fulfilled.

4.40 The specificity of promises to deliver services in a binding arrangement can be different in the public sector and can also vary greatly, from general promises that resources received will be used for the ongoing activities of a resource recipient, to specific promises about the type, quantity and/or quality of services to be delivered. Sometimes the specificity of services promised to be delivered by a resource recipient and agreed by the resource provider are implied rather than explicitly stated. Further, sometimes the specificity of the services expected to be delivered are reflected across a number of documents and mechanisms in the public sector that together represent a binding arrangement between a resource provider and resource recipient.

4.41 The IPSASB considers that the PSPOA could be appropriate for arrangements where services are specified or distinct so that performance obligations can be identified. In determining whether promises to deliver services are distinct, an entity would need to consider the nature, cost, value or volume to determine if performance obligations could be identified. Determining when there is a performance obligation will often require a greater level of judgement in the public sector than for for-profit transactions.

4.42 In an agreement where the resource recipient promises the resource provider it will deliver specified services to a beneficiary in return for consideration, it is more likely to be able to determine that there is a performance obligation and, as it should be clear when the services have been delivered and

therefore the performance obligation has been fulfilled. However, there might be agreements where delivery of services might not be specific or distinct so as to identify a performance obligation (e.g., where the resource recipient promises to a resource provider that it will use transferred resources to finance a range of possible activities). In such agreements it might be difficult to know what services have been transferred and when any performance obligations are fulfilled.

- 4.43 Therefore, under the PSPOA, if the services to be delivered in an arrangement were not distinct, the resource provider might need to combine a number of services until it had identified a bundle of services that were distinct to identify a performance obligation. The bundling of agreed services might result in delayed revenue recognition.
- 4.44 The identification of performance obligations and knowing when those performance obligations are fulfilled in an arrangement directly affects the timing of revenue recognition. Under a performance obligation approach revenue would not be recognized until the performance obligation had been fulfilled.
- 4.45 In developing a PSPOA, the IPSASB would need to consider whether a time requirement in and of itself creates a performance obligation. It is the IPSASB's view that a stipulation where an entity must transfer unspecified services within a particular time frame is unlikely to meet the "distinct services" criterion and therefore it is unlikely that a performance obligation exists. This means that many inter-governmental transfers where the time period for using the resources is specified, but the exact nature or quantity of the services are not specified would be considered to be Category A transactions for the purposes of this CP.
- 4.46 A key principle in IFRS 15 is that performance obligations only include activities that an entity must undertake to fulfil a contract and where those activities transfer a good or service to a customer. In developing a broadened PSPOA the IPSASB considers this principle would need to be preserved. For example, in the public sector many inter-governmental grants involve the provision of general funding to be used for the ongoing activities of the resource recipient. In many instances, the funding obliges the resource recipient to undertake a number of internal activities but not all of those activities would result in the direct transfer of services to a beneficiary.

Step 3 Determine the consideration

IFRS 15 characteristic

- 4.47 In IFRS 15 the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of consideration, but it may sometimes include variable consideration (which requires estimation) and non-cash consideration. Discounting for the time value of money may be required if the contract spans multiple reporting periods. IFRS 15 assumes that a contract with a customer to deliver promised goods or services has commercial substance. The reference to commercial substance in IFRS 15 is used to describe two characteristics assumed in a contract to deliver promised goods or services to a customer:
- (a) The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered; and
 - (b) The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services.

Step 3 broadened for the public sector

- 4.48 The IPSASB considers that the PSPOA could be applied to arrangements where the performance obligation depicts the amount of consideration the resource recipient expects to be entitled to for delivering services. Under the PSPOA, this step would be more easily achieved where the amount of consideration relates to the nature, cost, value or volume of delivery of services in a binding arrangement.
- 4.49 In general terms, in order to apply the PSPOA, there would need to be some linkage between the amount of agreed consideration and the fulfillment of performance obligations. As noted above, identification of performance obligations would be dependent on the specificity of the promises to deliver services in a binding arrangement so it could be known when those obligations are fulfilled. If consideration could not be allocated in some way to the fulfillment of performance obligations, the PSPOA would be unlikely to be an appropriate revenue recognition model for these transactions.
- 4.50 An indicator of whether a linkage between the amount of consideration and performance obligations could be demonstrated would be whether the arrangement provided for the amendment of the amount of consideration when agreed performance obligations were not fulfilled or were exceeded.

Step 4 Allocate the consideration

IFRS 15 characteristic

- 4.51 IFRS 15 defines the total amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer as the “transaction price”. The allocation of the transaction price to each performance obligation within a contract is an important step in the revenue recognition model, because it determines how much revenue will be recognized when (or as) performance obligations are fulfilled.
- 4.52 IFRS 15 requires the transaction price to be allocated to each performance obligation where the performance obligation depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. The transaction price is allocated to each performance obligation on the basis of the relative stand-alone selling price of each distinct good or service. If a stand-alone selling price is not observable, an entity is required to estimate it. IFRS 15 provides examples of methodologies an entity could choose to use to determine or estimate the stand-alone selling price.

Step 4 broadened for the public sector

- 4.53 In the public sector, due to the integrated nature of the services provided, stand-alone selling prices may not be straightforward to identify. Also, many public sector entities do not compete directly with private sector entities and may not set prices for services based on market considerations. However, many public sector entities receive consideration in exchange for the fulfillment of performance obligations, which involve the delivery of services to the public. For example, consideration received by a subnational entity from central government to deliver education and health care services to the public.
- 4.54 In developing the PSPOA, the IPSASB considers it would be appropriate to place less emphasis on the need to determine the “stand-alone selling price” and instead focus on an entity’s ability to determine the cost of fulfilling each performance obligation, as a basis for allocating the total amount of agreed consideration to each performance obligation.

Step 5 Recognize revenue

IFRS 15 characteristic

4.55 Under IFRS 15 an entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognized is the amount allocated to the fulfilled performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.

Step 5 broadened for the public sector

4.56 Under a PSPOA a public sector entity would also recognize revenue when (or as) it fulfilled performance obligations by delivering promised services in a binding arrangement. However, the application of the fifth step in a PSPOA would be dependent on the conclusions reached on how far the PSPOA was broadened under each of the previous steps.

4.57 The recognition of revenue as performance obligations are fulfilled relies on the ability of the resource recipient (the entity which receives the consideration and accepts responsibility for the delivery of services) to determine that a performance obligation has been fulfilled or is in the process of being fulfilled. This would be particularly important in arrangements where the wider public receives the benefits of those performance obligations, rather than the resource provider directly.

4.58 Under the PSPOA, the timing of cash flows between the resource provider and resource recipient would not affect the pattern of revenue recognition. Revenue would be recognized when (or as) performance obligations were fulfilled. Consideration for the delivery of promised services received in advance of fulfilling the performance obligation, would give rise to a liability of the resource recipient.

Advantages and Disadvantages of the potential approaches

4.59 This chapter has established two overall approaches that could be adopted to address accounting for Category B transactions. Approach 1 Options (a)-(e) would continue to treat Category B transactions in an updated IPSAS 23 and are specifically aimed at addressing issues identified with that IPSAS. Approach 1 Option (a) could be used in isolation or in combination with Approaches 1 Options (b)-(e). Approach 2 is a standalone approach for Category B transactions and proposes to broaden the five-step approach in IFRS 15 to make it appropriate for use in a public sector environment.

4.60 Each approach (and the options within) has advantages and disadvantages. The IPSASB has evaluated each approach against four factors in Appendix A:

- (a) Is it consistent with the IPSASB *Conceptual Framework*;
- (b) Is it consistent with current IPSAS;
- (c) Will it resolve the difficulty with the exchange/non-exchange distinction; and
- (d) Does it enable revenue transactions with time requirements able to be recognized over more than one reporting period (if applicable)?

4.61 The matrices following paragraph 4.64 summarize the advantages and disadvantages discussed in Appendix A for each potential approach. The first matrix assumes Approach 1 Options (b)-(e) are not used in combination with Approach 1 Option (a), whereas the second matrix assumes Approach 1 Option (a) is used in combination with Approaches 1 Options (b)-(e).

Implementation costs

4.62 The IPSASB is aware that the introduction of a new standard or a change to an existing standard is likely to impose costs on preparers. The extent of such costs will depend on which approach is adopted. However, it is difficult to estimate the extent of these costs as the impact will be entity specific.

4.63 While it is not possible to identify all the costs associated with any new or modified accounting standard, the IPSASB considers that costs expected to be incurred include, but are not limited to:

- (a) Understanding the changes in a standard or the impact of a new standard. This impact analysis may require research and obtaining external advice;
- (b) Determining if there will be a change of an entity's accounting policy or a modification to an existing one. This may also require obtaining external advice on the practical application of a new or changed standard;
- (c) If there is a change of accounting policy, existing contracts and binding arrangements would need to be reviewed and the current accounting revisited;
- (d) Systems changes, for example updating chart of accounts and new codes required to collect information or detailed analysis; and
- (e) Training and education of staff in the application of a new or modified accounting policy; possible changes to computer systems, source ledgers and/or broader public financial management processes or mechanisms (e.g., appropriation and authorizations). Some costs associated with a change in accounting policy are "one-off" while others will have an ongoing impact.

4.64 Because of the difficulty with estimating implementation costs, and the fact that each entity's existing accounting policy will have a different starting point, it is not possible to make an assessment about the relative implementation costs in relation to each of the options when comparing the advantages and disadvantages in the matrices below.

Matrix 1 – Potential Advantages and Disadvantages of Approaches						
Assumes extra guidance on making the exchange/non-exchange distinction IS NOT included with approaches 1(b) – 1(e)						
	Approach 1					Approach 2
	Option (a)	Option (b)	Option (c)	Option (d)	Option (e)	
	Provide additional guidance on making the Exchange/Non-Exchange determination	Address transactions with time requirements (and no other stipulations) via:				Public Sector Performance Obligation Approach for Revenue
		Require enhanced display/disclosure	Classify time requirements as a condition	Classify transfers with time requirements as other obligations	Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance	
Consistent with the IPSASB Conceptual Framework	✓	✓	✗	✓	✓	✓
Consistent with IPSAS	✓	✓	✗	Not Applicable	✓	✓
Resolves Exchange/Non-Exchange Determination	?	✗	✗	✗	✗	✓
Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)	✗	✗	✓	✓	✓	?

Matrix 2 – Potential Advantages and Disadvantages of Approaches						
Assumes extra guidance on making the exchange/non-exchange distinction IS included with approaches 1(b) – 1(e)						
	Approach 1					Approach 2
	Option (a)	Option (b)	Option (c)	Option (d)	Option (e)	
	Provide additional guidance on making the Exchange/Non-Exchange determination	Address transactions with time requirements (and no other stipulations) via:				Public Sector Performance Obligation Approach
		Require enhanced display/disclosure	Classify time requirements as a condition	Classify transfers with time requirements as other obligations	Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance	
Consistent with the IPSASB Conceptual Framework	✓	✓	✗	✓	✓	✓
Consistent with IPSAS	✓	✓	✗	Not Applicable	✓	✓
Resolves Exchange/Non-Exchange Determination	?	?	?	?	?	✓
Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)	✗	✗	✓	✓	✓	?

Preliminary View 3

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

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

Specific Matter for Comment 2

The IPSASB has proposed to broaden the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

Step 1 – Identify the binding arrangement (paragraphs 4.29 - 4.35);

Step 2 – Identify the performance obligation (paragraphs 4.36 - 4.46);

Step 3 – Determine the consideration (paragraphs 4.47 – 4.50);

Step 4 – Allocate the consideration (paragraphs 4.51 – 4.54); and

Step 5 – Recognize revenue (paragraphs 4.55 – 4.58).

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened?

If not, please explain your reasons.

Specific Matter for Comment 3

If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favor for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

(a) Option (b) – Require enhanced display/disclosure;

(b) Option (c) – Classify time requirements as a condition;

(c) Option (d) – Classify transfers with time requirements as other obligations; or

(d) Option (e) - Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.

Please explain your reasons.

Specific Matter for Comment 4

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

(a) Yes

(b) No

Please explain your reasons.

5. Chapter 5: Current IPSAS 23 Issues – Capital Grants and Services in-kind

- 5.1 Preparers have identified various issues with applying IPSAS 23 in practice which include:
- (a) The difficulty with making the exchange/non-exchange determination;
 - (b) The requirement to recognize revenue with only a time requirement limitation immediately when receivable – this may not provide a faithful representation of the intent behind the transactions (see discussion above);
 - (c) The uneven profile of revenue recognition from capital grants; and
 - (d) The difficulty of measuring revenue from donated services in-kind.
- 5.2 The difficulty with making the exchange/non-exchange determination and time requirements are addressed in Chapter 4. Therefore, this chapter will discuss capital grants and services in-kind.
- 5.3 This Chapter does not make any proposals on how these problems can be solved but rather aims to ensure that all the relevant factors are identified.

Capital Grants

- 5.4 The main concern that constituents have raised with regard to accounting for capital grants is the pattern of revenue recognition. Although not explicitly addressed in IPSAS 23, revenue from capital grants is likely to be recognized in an uneven profile, dependent on whether the grant funding agreement includes restrictions, conditions or a mixture of the two. If the funding arrangement does not have conditions, revenue will be recognized as the grant becomes receivable; if the funding arrangement has conditions the pattern of recognition will be more “lumpy”. For example, if the condition attached to a grant for refurbishment of a building is that the grant is repayable in full up to the point at which that building becomes operational, revenue would only be recognized at the point of when the building becomes operational. The profile of revenue recognition would be very different for a grant that adopts a “stage of completion” approach in which conditions are met as parts of the building is completed. This has led some preparers to prefer an accounting treatment based on IAS 20, *Government Grants and Disclosure of Government Assistance*, in which revenue is either recognized in surplus or deficit on a systematic basis over the useful life of the asset financed by the grant or as an offset to a depreciation expense. The IPSASB does not support these treatments because they are not consistent with the IPSASB *Conceptual Framework*.
- 5.5 The IPSASB has received feedback that the current requirements are ambiguous to apply for capital grants. In particular, it may not be clear exactly what constitutes a condition. For example, some capital grants contain stipulations that the resources must be used to construct or acquire capital assets for delivery of specified services and if use of the capital asset for delivery of those assets is discontinued, the grant is repayable. The issue is whether such a stipulation is a condition, which may mean that a recipient entity must recognize a continuing liability that it does not derecognize, or a restriction. Can the entity argue that it can avoid repayment by continuing to use the asset for the provision of specified services? If a restriction, what should the pattern of recognition of the grant be?

Preliminary View 4

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

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

Specific Matter for Comment 5

- (a) Has the IPSASB identified the main issues with capital grants?
If you think that there are other issues with capital grants please identify them.
- (b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?
Please explain your issues and proposals.

Services In-kind

- 5.6 Currently IPSAS 23 permits, but does not require, the recognition of services in-kind²². The Basis for Conclusions (BC) of IPSAS 23 explains that many services in-kind do meet the definition of an asset, and should, in principle, be recognized. IPSAS 23.BC 25 acknowledges that there may be difficulties in obtaining reliable measurements. A further complicating factor is that services in-kind may not give rise to an asset because the reporting entity has insufficient control of the services provided and therefore of the resource. Determining whether the level of control is “sufficient” may be ambiguous. For these reasons, the IPSASB concluded that entities should be permitted, but not required, to recognize services in-kind.
- 5.7 Some argue that the existence of options reduces comparability between entities and that the provisions related to services in-kind should be more clear-cut. As previously indicated, services in-kind can be material for some international organizations. The IPSASB *Conceptual Framework* has reaffirmed that services in-kind will often meet the definition of an asset²³. In this respect they do not differ from goods in-kind, which IPSAS 23 states should be recognized as assets when the goods are received, or there is a binding arrangement to receive the goods. Therefore, the assumption should be that services in-kind should be recognized provided the entity controls the services provided and those services can be measured in a way that achieves the qualitative characteristics and takes account of the constraints of financial reporting. In most cases, it will be feasible to obtain a viable measure of the services provided by reference to the cost of obtaining such services in an observable commercial transaction.
- 5.8 A contrary view is that for some entities the cost of obtaining such information is greater than the benefit to users of the information. Therefore, the current requirement in IPSAS 23 that permits, but does not require, the recognition of services in-kind should be retained.
- 5.9 Recently some national standard-setters have considered this issue. Approaches have included:
- (a) Requiring services in-kind to be recognized as an asset (or as an expense when the definition of an asset is not met) by public sector entities when the fair value can be measured reliably and the services would have been purchased if they had not been donated;

²² Services in-kind are services provided by individuals to public sector entities in a non-exchange transaction. These services meet the definition of an asset because the entity controls a resource from which service potential or economic benefits are expected to flow to the entity.

²³ Many services in-kind are consumed immediately and recognized as revenue and an expense: for example, volunteer services from teachers' aides that can be measured reliably are recognized as an increase in an asset and revenue and immediately thereafter a decrease in that asset and an increase in expense. However, other services in-kind that meet the definition of an asset may not be consumed immediately and are recognized as an asset and as revenue; for example, when a service is used in the construction of an asset the service in-kind would be recognized as part of the cost of that asset (e.g., electrical services for construction of a building).

- (b) Allowing entities to recognize services-in-kind if the fair value of those services can be measured reliably regardless of whether the services would have been purchased if not donated; or
- (c) Requiring services in-kind to be recognized if they are significant in the context of an entity's overall activities.

The IPSASB welcomes views as to whether such approaches are useful in the IPSASB's consideration of whether the requirements for services in-kind should be modified.

Specific Matter for Comment 6

Do you consider that the IPSASB should:

- (a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or
- (b) Modify requirements to require services in-kind that meet the definition of an asset, to be recognized in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or(b)
- (c) An alternative approach.

Please explain your reasons. If you favor an alternative approach, please identify that approach and explain it.

6. Chapter 6 – Non-Exchange Expenses – Recognition Approaches

6.1 This Chapter identifies the transactions that are within the scope of this CP (based on the current proposals on scope and definition in the draft Social Benefits ED and existing IPSAS²⁴). It outlines and evaluates two potential approaches for the recognition of non-exchange expenses.

Scope of Non-Exchange Expense Transactions within this Consultation Paper

6.2 This CP addresses non-exchange expenses, which comprise:

- (a) Collective services
- (b) Universally accessible services; and
- (c) Grants, contributions and other transfers²⁵.

6.3 The IPSASB currently has an active project on accounting for social benefits, which excludes non-exchange expenses, but encompasses benefits that are provided to:

- (a) Specific individuals and/or households who meet eligibility criteria;
- (b) Mitigate the effect of social risks; and
- (c) Address the needs of society as a whole; but
- (d) Are not universally accessible services.

6.4 The key aspect of a social benefit is that the benefit is provided to mitigate social risk. Therefore, the types of non-exchange expenses included in the Social Benefits project are principally:

- (a) State pensions;
- (b) Unemployment benefits; and
- (c) Income support.

6.5 Other expenses that are considered to be exchange transactions (e.g., contracts for insurance, contracts for services on a commercial basis and employee benefits) are not covered by this CP.

6.6 The diagram below illustrates which types of expenses are included in this project and which ones are included in the Social Benefit project or addressed by an existing accounting standard. It also indicates the scope of the definition of social benefits in Government Finance Statistics (GFS).

²⁴ There are a number of existing IPSAS and IFRS that address other expense transactions e.g., IPSAS 25 and 39, Employee Benefits, IPSAS 28-30 on Financial Instruments and IFRS 16, *Leases*. In addition, a number of IPSAS have some element of expense recognition e.g., IPSAS 17, *Property, Plant and Equipment*.

²⁵ Other transfers includes services in-kind.

ACCOUNTING FOR REVENUE AND NON-EXCHANGE TRANSACTIONS

Category	Non-Exchange Expenses Project			Social Benefits	Other IPSAS / IFRS			
	Grants, Contributions and Other Transfers	Collective Services	Universally Accessible Services		Social Benefits	Employee Benefits	Contracts for Insurance	Contracts for Goods and Services
Examples	Grants to other public sector entities Grants to charities Disaster Relief	Defense Street lighting	Universal Education	Universal Healthcare	State pensions Unemployment benefits Income support	Salaries Healthcare Employee pensions	Vehicle insurance Private medical insurance	Purchase of goods Payment for services
Exchange or Non-Exchange Transaction?	Non-Exchange	Non-Exchange	Non-Exchange	Non-Exchange	Exchange	Exchange	Exchange	
Provided to specific individuals/households who meet eligibility criteria?	Sometimes	No	No	Yes	Yes	No	No	
Mitigates effect of social risks?	No	No	No	Yes	Yes	No	No	
Addresses needs of society as a whole?	Sometimes	Yes	Yes	Yes	No	No	No	
Excludes universally accessible services?	Sometimes	Yes	No	No	Yes	Yes	Yes	

Scope of Social Benefits in GFS

Universally Accessible Services

- 6.7 The draft Social Benefits ED defines “Universally accessible services” as: “Those that are made available by a government entity for all individuals and/or households to access, and where eligibility criteria (if any) are not related to social risk”.
- 6.8 As noted above, examples of universally accessible services include education and health services. For example, a government school that provides education for all children aged five or over. Access to specific government schools is often based on whether the child lives within a specified proximity to that school.
- 6.9 As indicated in the diagram above, “universal healthcare” is provided to mitigate social risk and is therefore considered to be a social benefit under GFS. However, the IPSASB decided that rather than split universally accessible services between the Social Benefits and Revenue and Non-Exchange Expenses projects (i.e., universal healthcare in the Social Benefits project and universal education in the Revenue and Non-Exchange project), the Social Benefits project would include a specific scope exclusion in respect of universally accessible services. Therefore, this CP includes all universally accessible services.

Collective Services

- 6.10 Collective services have the following characteristics:
 - (a) They are delivered simultaneously to each member of the community or section of the community;
 - (b) Individuals cannot be excluded from the benefits of collective services;
 - (c) The provision of a collective service to one individual does not reduce the amount of that service available to others: that is, it is not exclusive in nature; and

- (d) The use of a collective service is usually passive – that is, it does not require the explicit agreement or active participation of individual recipients.

6.11 Examples of collective services include, but are not limited to:

At a national government level:

- (a) The provision of defense;
- (b) The conduct of international relations;
- (c) The provision of public order and safety; and

At a local government level:

- (d) The provision of street lighting.

Grants, contributions and other transfers

6.12 Grants, contributions and other transfers include:

- (a) Specific grants which include detailed conditions and performance obligations on the part of the recipient (e.g., a research grant);
- (b) General grants with no performance obligations or conditions (e.g., to finance the overall activities of an entity); or
- (c) Other transfers that may be related to specific and irregular events, (e.g., urgent assistance provided to individuals and or households following a hurricane or earthquake).

Potential recognition approaches

6.13 Currently, there is no IPSAS that specifically addresses how to account for all expenses arising from non-exchange transactions. Consequently, in the absence of an IPSAS a number of preparers have used IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* to develop accounting policies. However, a problem with using the requirements in IPSAS 19 is that it is restricted to contingent liabilities and provisions, which can be distinguished from other liabilities (such as payables and accruals) because there is uncertainty about the timing or amount of the future expenditure required in settlement. As such, IPSAS 19 is not applicable to all liabilities.

6.14 Therefore, this section explores proposals for two approaches that can be applied for the initial recognition of the non-exchange expenses within the scope of this CP. These approaches are:

- (a) The Extended Obligating Event Approach; and
- (b) The Public Sector Performance Obligation Approach.

The Extended Obligating Event Approach

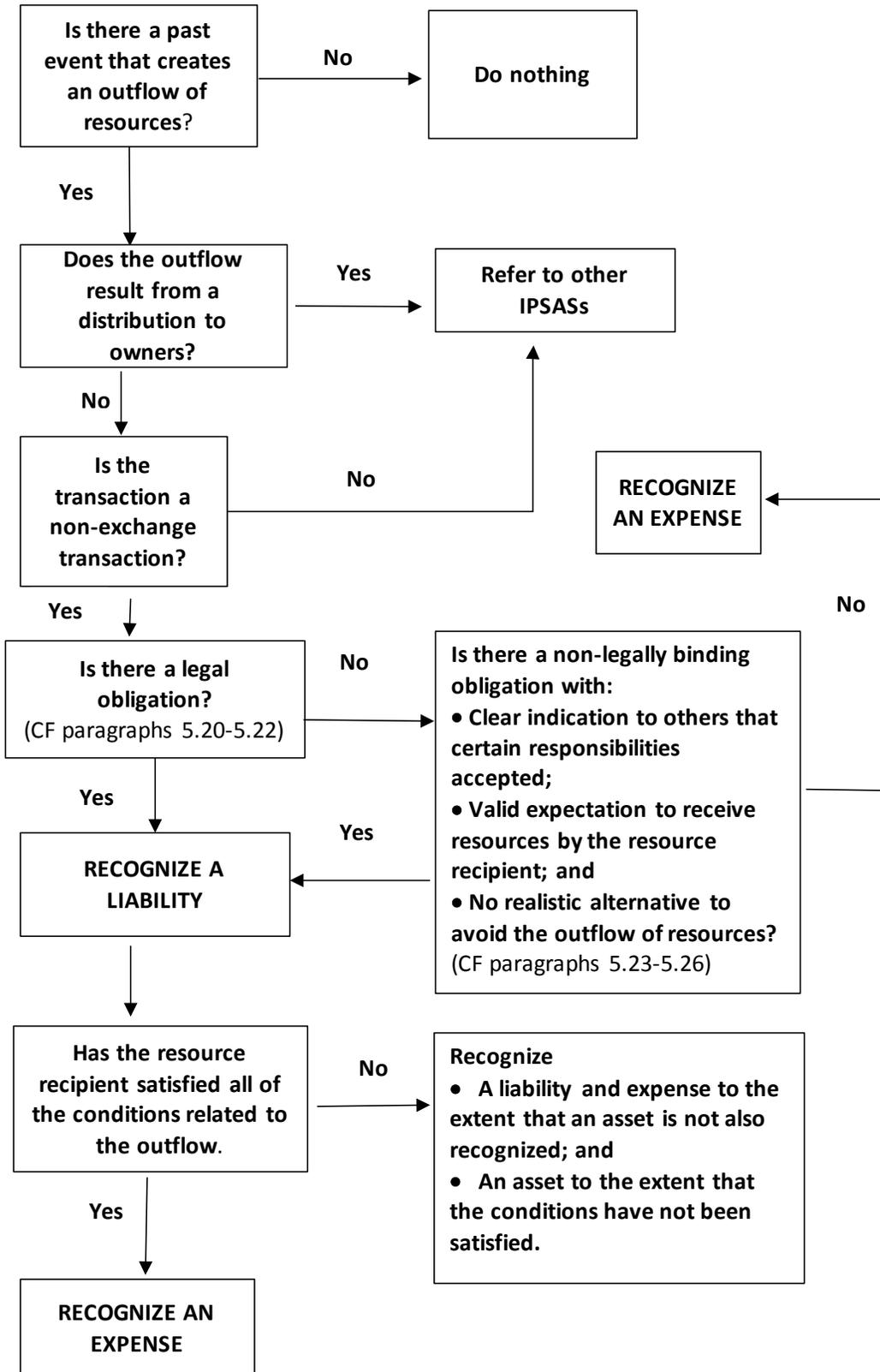
6.15 The Extended Obligating Event Approach is based on the concept of a liability in the IPSASB *Conceptual Framework*, whereby the determining factor of whether a resource provider of resources has a liability and a corresponding expense or asset (depending on the circumstances) is whether there is an obligating event. That is to say, an event that creates a legal obligation or non-legally binding obligation that results in the resource provider having no realistic alternative to settling that obligation.

- 6.16 Under this approach, the IPSASB proposes that a resource provider would determine when that entity should recognize a liability based on whether an obligating event exists or not. For transactions that include stipulations (see paragraph 2.7) on the resource recipient, then a mirrored approach to IPSAS 23 would be used to determine whether expenses related to that liability are recognized immediately or recognized over time.
- 6.17 Legally binding obligations are a matter of fact in that they are enforceable in law or by equivalent means. These binding obligations often arise from contracts.
- 6.18 Non-legally binding obligations that give rise to liabilities have the following attributes²⁶:
- (a) The entity must have given a sufficiently precise indication to other parties that it will accept certain responsibilities;
 - (b) This indication gives rise to a valid expectation that, on the part of other parties, it will discharge those responsibilities; and
 - (c) The entity has little or no realistic alternative to settle the obligation arising from those responsibilities.
- 6.19 Where there are stipulations the resource provider will determine whether these stipulations are conditions or restrictions (see the discussion in paragraphs 2.6 – 2.9). If an agreement contains only restrictions the resource provider will recognize an expense for the entire amount of the transfer. This is because in the event of a breach of a restriction by the resource recipient, the resource provider has no enforceable right to recover the resources. Where there are breaches of restrictions, the resource provider may have the option of seeking a penalty against the resource recipient by legal or administrative processes. Such actions may result in a direction that the entity fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. However, as explained in IPSAS 23, such a remedy is the result of the resource recipient breaching the restriction and is not attached to the transferred resource itself, therefore it is treated as a separate transaction.
- 6.20 If the agreement contains a condition the resource provider would not recognize an immediate expense for the entire amount of the transfer, but will recognize an asset until that condition has been fulfilled by the resource recipient. Once a condition has been fulfilled, the resource provider will recognize an expense and decrease the corresponding asset.
- 6.21 An asset is initially recognized because in the event of the resource recipient breaching the condition, the resource provider has an enforceable right to require the resource recipient to return the resources. Therefore, the resource provider controls those resources until the condition is fulfilled. In many arrangements there will be a number of conditions, therefore the resource provider will have to determine the amount of the funding that relates to the satisfaction of a particular condition, so that a faithfully representative portion of the funding may be recognized as an expense.
- 6.22 As noted in paragraph 1.7 tripartite arrangements often exist for non-exchange expense transactions, that is, a resource provider transfers funds to a resource recipient to deliver services to a beneficiary. Therefore, expense recognition by the resource provider is determined as the resource recipient fulfills the requirements of the transfer. Consequently, there needs to be appropriate and adequate reporting between the resource provider and resource recipient.

²⁶ Paragraph 5.23 of The IPSASB Conceptual Framework

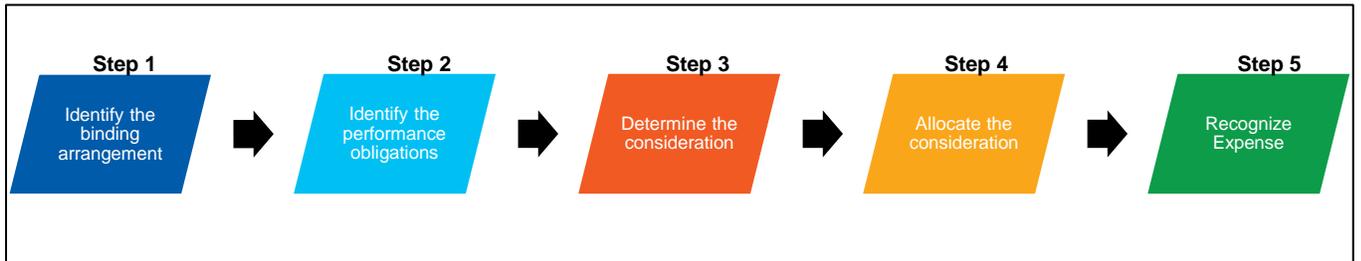
- 6.23 In the case of a grant, contribution or other transfer where there are no stipulations, the resource provider would recognize either a liability in the form of a payable, or a reduction of cash (depending on the timing of the transfer of resources) and an expense for the entire amount of the transfer.
- 6.24 The Social Benefits project is also proposing to use an obligating event approach for the recognition of social benefit liabilities.
- 6.25 The diagram below, which is adapted from the flowchart in Chapter 2, illustrates the decision tree for The Extended Obligating Event Approach.

THE EXTENDED OBLIGATING EVENT APPROACH



The Public Sector Performance Obligation Approach for Expenses

- 6.26 The PSPOA for non-exchange expenses would be the counterpart to the PSPOA approach for revenue transactions discussed in Chapter 4. The five steps of the PSPOA that are discussed would be modified to reflect non-exchange expenses. In essence, the approach to non-exchange expenses would involve the resource provider recognizing an expense when the resource recipient satisfies identified performance obligations.
- 6.27 As indicated in Chapter 4 the satisfaction of a performance obligation might involve the delivery of services to a beneficiary rather than the resource provider. Where necessary, the key characteristics in Chapter 4 have been modified to reflect a resource provider perspective. This section does not repeat the analysis in Chapter 4.



Step 1 Identify the binding arrangement

- 6.28 The PSPOA would include binding arrangements with performance obligations established through legislation, regulation or other arrangements that are not limited to contracts.

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

- 6.29 A key feature of the PSPOA is that expense recognition is aligned with the fulfilment of a performance obligation. Therefore, for a resource provider to defer the recognition of an expense the arrangement must contain performance obligations that the resource recipient is required to fulfil. Where the arrangement involves two parties, evaluating whether the resource recipient has satisfied a performance obligation may be relatively straightforward for the resource provider. However, tripartite arrangements in which a public sector entity (resource provider) provides resources to another entity (resource recipient) that benefits another party (beneficiary) might present challenges. In such cases, resource providers would need to evaluate arrangements between resource recipients and beneficiaries so that information was available in order to determine whether the performance obligations of the resource recipients had been satisfied.

Step 3 Determine the consideration

- 6.30 The PSPOA would be applicable to arrangements where the amount of consideration is determined by the resource provider based on the level of agreed services to be delivered by the resource recipient according to the following principles:

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

6.31 The total amount of consideration would be the amount the resource provider expects to incur in an enforceable arrangement.

Step 4 Allocate the consideration to each identifiable performance obligation

6.32 The resource provider would allocate the total amount of consideration to each performance obligation in a way that depicted the amount of consideration the resource provider expected to incur as a result of the satisfaction of the performance obligations by the resource recipient.

6.33 The nature of many transactions in the public sector is such that stand-alone prices may not exist for the promised services or for other performance obligations described in an enforceable arrangement. In such circumstances it would prove difficult to determine the stand-alone selling price of each performance obligation therefore, the resource provider would bundle a number of distinct services to identify a performance obligation to be fulfilled by the resource recipient.

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

6.34 The trigger for expense recognition for the resource provider is when the resource recipient fulfills the performance obligation(s) in the arrangement. In transactions involving three parties, the resource provider recognizes an expense when (or as) the resource recipient delivers the promised services to the beneficiary (i.e., it fulfills the performance obligation). This relies on the resource provider being able to determine that the resource recipient has satisfied the performance obligation. This could be more complex in arrangements where services are provided to third party beneficiaries.

6.35 How a resource recipient provides information to a resource provider regarding satisfaction of performance obligations could depend on the requirements of the funding agreement. Determination of the satisfaction of performance obligations could be evidenced by reporting on progress to the resource provider. This might be a single progress report for a performance obligation satisfied at a point in time or a series of progress reports for a performance obligation satisfied over a period.

Applicability of potential recognition approaches to the various types of Non-Exchange Expenditure

Universally accessible services and collective services

6.36 Applying the transaction categories outlined at paragraph 3.3, the IPSASB considers that universally accessible services and collective services are Category A transactions because these types of transaction contain no performance obligations or stipulations that the resource recipient is required to fulfil as a result of receiving the services from the resource provider.

6.37 Consequently, the IPSASB has concluded that both universally accessible services and collective services should be accounted for under The Extended Obligating Event Approach. As the diagram following paragraph 6.25 illustrates, this approach also deals with situations where no obligating event arises.

Preliminary View 5

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event Approach.

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

- 6.38 A public sector entity may have a number of future obligations relating to the provision of universally accessible services and collective services. Such obligations are an aspect of the ongoing activities of governments and other public sector entities; however, only present obligations give rise to liabilities. The expected future sacrifice of resources does not of itself mean that there is a present obligation. This is because although beneficiaries may have an expectation that services will be provided, governments (resource providers) can vary the level of such services so that the availability of those services may be limited. Therefore, the IPSASB is of the view that universally accessible services and collective services do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of those services to beneficiaries.
- 6.39 The Extended Obligating Event Approach requires consideration of whether the resource recipient has satisfied all the conditions related to the outflow. As there is no obligating event for either universally accessible services or collective services, the IPSASB has concluded that no present obligations would arise, and so an expense should be recognized as expenses as incurred.

Preliminary View 6

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

- 6.40 The Board notes that the delivery of universally accessible services and collective goods may involve a number of exchange transactions (e.g., employee benefits and contracts with suppliers on a commercial basis), that are not covered by this CP.

Grants, contributions and other transfers

- 6.41 Grants, contributions, and other transfers may be either Category A or Category B transactions depending on whether the resource provider imposes any performance obligations or stipulations on the resource recipient as a result of receiving the resources. For example, grants with performance obligations or stipulations would be classified as Category B, whereas a grant with no performance obligations or stipulations on the resource recipient would be classified as Category A.
- 6.42 The IPSASB considers that for these types of transactions there are arguments in favor of adopting either The Extended Obligating Event Approach or the PSPOA. However, the IPSASB is of a view that it is important for the approach in a Non-Exchange Expenses standard to mirror the approach adopted for equivalent revenue transactions. As previously indicated the IPSASB's preliminary view for revenue is to use the PSPOA. Consequently the IPSASB proposes that Category B grants, contributions and other transfers should also be accounted for under the PSPOA as outlined in this chapter.

Preliminary View 7

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations, they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons.

7. Chapter 7: Measurement

Introduction

- 7.1 The purpose of this chapter is to discuss measurement at initial recognition and subsequent measurement of non-contractual receivables and non-contractual payables. This chapter does not consider contractual receivables and contractual payables, because such transactions meet the definition of a financial instrument in IPSAS 28, *Financial Instruments: Presentation* and are addressed in IPSAS 28-30.
- 7.2 As noted below, both non-contractual receivables and non-contractual payables contain many of the features of financial instruments, as defined in IPSAS 28. The IPSASB currently has a project to update IPSAS 28-30, primarily to reflect IFRS 9, *Financial Instruments*. The financial instruments project has retained the term “fair value”. For consistency with that project this CP retains the term fair value rather than using measurement terms in the IPSASB Conceptual Framework.

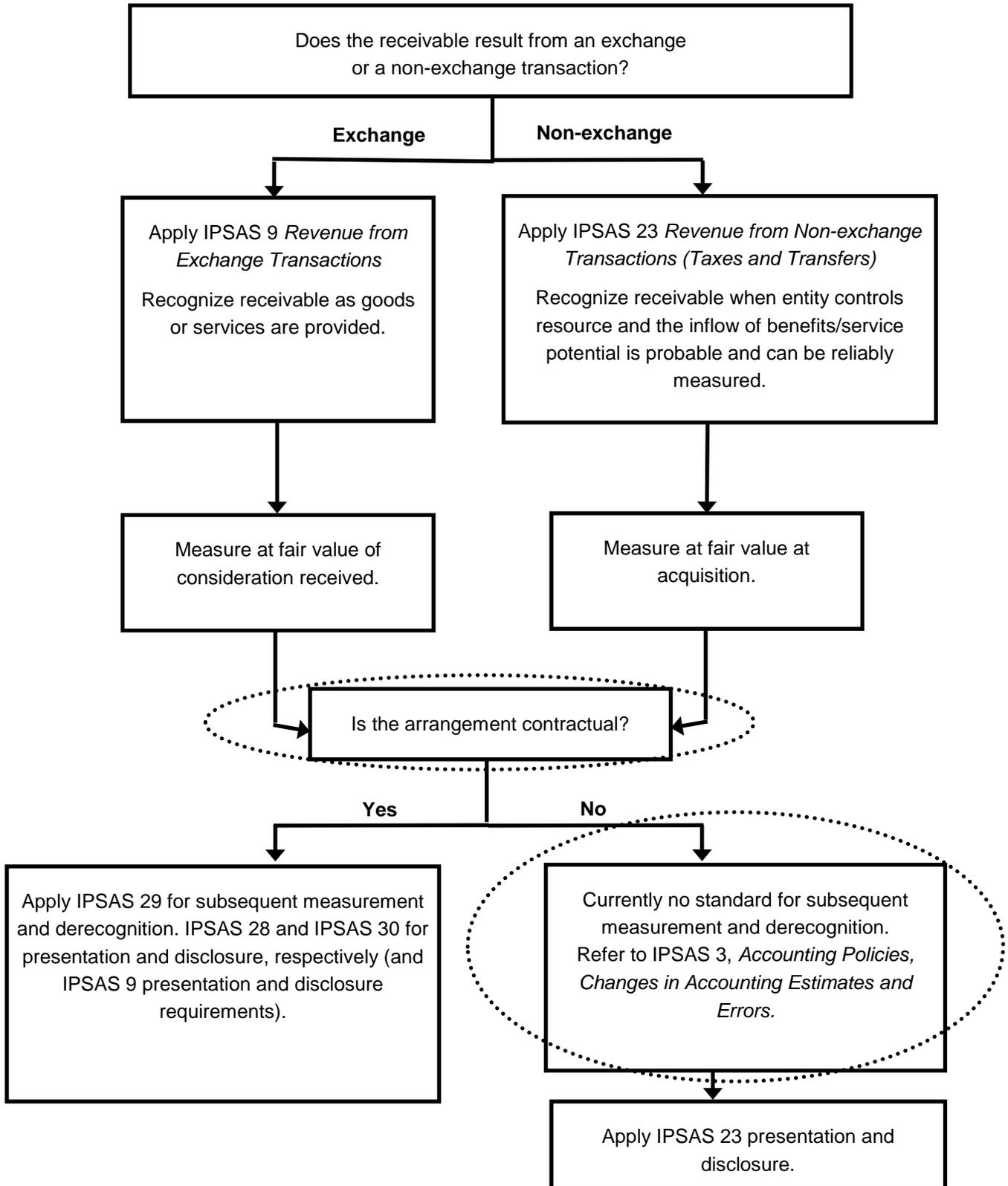
Non-Contractual Receivables

- 7.3 Non-contractual receivables may take several forms with the most common in the public sector being statutory receivables. These are receivables that arise from legislation, supporting regulations or similar mechanisms and require settlement in cash or another financial asset. Because of this settlement requirement they have many of the features of financial instruments as defined in IPSAS 28. However, as the terminology indicates, they are non-contractual in nature. In addition many transactions do not involve willing parties.
- 7.4 The principal examples of statutory receivables are:
- (a) Taxes;
 - (b) Government transfers (in some cases);
 - (c) Fines and penalties;
 - (d) Fees; and
 - (e) Licenses.
- 7.5 Donations, and bequests although less common in the public sector than in the private not-for-profit sector, are examples of non-contractual receivables that might not be statutorily-based.

Current position and potential approaches

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

Recognition and Measurement of Contractual and Non-Contractual Receivables – Current Literature.



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

Measurement at Initial Recognition

- 7.8 As indicated in the above diagram, requirements and guidance for the measurement at initial recognition of non-contractual receivables which are classified as non-exchange transactions are in IPSAS 23. Non-contractual receivables that are classified as exchange transactions are initially recognized and measured in accordance with IPSAS 9 – these are most likely to be licences and fees. Both IPSAS 9 and IPSAS 23 require initial recognition at fair value.
- 7.9 IPSAS 9.11 defines fair value as “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”.
- 7.10 Some constituents have expressed concerns about the appropriateness and interpretation of the fair value requirements in IPSAS 23 for non-contractual receivables. This particularly applies to taxes, fines and penalties.
- 7.11 Although there is no specific standard addressing how to determine fair value²⁷ IPSAS 29, *Financial Instruments: Recognition and Measurement* does provide guidance on determining fair value for financial assets and financial liabilities. This can be applied to non-contractual receivables by analogy (via the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* paragraphs 12-15).
- 7.12 IPSAS 29.51 suggests that the best evidence of fair value is quoted prices in an active market. If no active market exists then fair value is established using a valuation technique. This paragraph further states that the objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm’s length exchange motivated by normal operating considerations.
- 7.13 The main issue in the determination of fair value is that there is unlikely to be a market for these transactions, and in the limited circumstances where there is a market, that market is unlikely to be active. If there is no active market a valuation technique would need to be applied to determine the transaction price on the measurement date.
- 7.14 Often the transaction price may be set in legislation and/or predetermined, for example fines for breaking traffic legislation. In such cases, establishing the transaction price may be relatively straightforward to determine. In other cases, such as many taxes, complex estimation may be required.
- 7.15 Depending on the expected timing of the receipt of payment for some non-contractual receivables it may be necessary to consider discounting the transaction price to account for the time value of money. Determining an appropriate discount rate is therefore a further complication. High levels of inflation will need to be taken into account where these are present in a jurisdiction.

²⁷ There is no equivalent to IFRS 13 Fair Value Measurement in the IPSAS suite of standards. The IPSASB currently has a project on Public Sector Measurement.

- 7.16 To address this issue the IPSASB has identified two options:
- (a) The best estimate of the discounted cash flows expected to be received by the entity. Under this approach, non-contractual receivables and revenue are initially recognized at discounted value, with no identification of uncollectible amounts; or
 - (b) The face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.
- 7.17 Proponents of option (a) argue that it provides the most realistic and faithfully representative measure of the revenue accruing to the entity. According to this view, recognizing revenue for face value (legislated) amounts, when a large proportion of the amount receivable is known to be uncollectible, does not provide a faithfully representative measure.
- 7.18 Proponents of option (b) argue that the approach promotes accountability and is in the public interest. Where uncollectible amounts are significant, management and elected officials need to provide explanations. Sovereign power is exercised through the use of constitutionally and legally sanctioned authority. If it is assumed that tax payers and fines-payers are willing to abide by constitutionally and legally sanctioned processes, then it can be argued that they are willing to pay the amount levied. On that basis, the initial fair value of receivables arising from the exercise of sovereign power should be the amount owed,

Preliminary view 8

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

Subsequent Measurement

Current position and potential approaches

- 7.19 Requirements and guidance on subsequent measurement, derecognition and impairment of non-contractual receivables are not provided in the current IPSASB literature. Therefore, in the absence of a specific standard, some jurisdictions have developed their own policies. Those identified by the IPSASB are (i) applying IPSAS 29, by analogy or (ii) developing accounting policies using the hierarchy in IPSAS 3.
- 7.20 Non-contractual receivables are usually settled in cash, therefore it could be argued that they are very similar to financial assets. IPSAS 28 defines a financial asset in paragraph 9(c)(i) as *a contractual right to receive cash or another financial asset from another entity*.
- 7.21 An argument against using financial instruments standards to develop accounting policies for subsequent measurement is that receiving cash or another financial asset from a contractual right is a key feature of a financial asset as defined above and obviously not a feature of non-contractual receivables. Therefore, some opponents consider that it is not appropriate to apply the financial instrument standards, even by analogy.
- 7.22 Conversely, it may be argued that the existence of a contract is merely part of the form of the transaction and that the substance of the arrangement is akin to a financial asset settled in cash. Therefore, it is appropriate to apply the financial instrument principles by analogy.

- 7.23 In accordance with these two views, this section of the CP outlines three potential approaches to subsequent measurement. These three approaches were discussed in the South African Accounting Standards Board's 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments*.²⁸ These approaches have been developed after considering the accounting practices for non-contractual receivables of other jurisdictions.²⁹
- 7.24 These approaches are:
- (a) Approach 1 - Fair Value Approach;
 - (b) Approach 2 - Amortized Cost Approach; and
 - (c) Approach 3 - Cost Approach.
- 7.25 Approaches 1 and 2 use the principles in the financial instruments standards while Approach 3 uses the principles in IPSAS 26, *Impairment of Cash-Generating Assets*.

Approach 1– Fair Value Approach

- 7.26 Under Approach 1 non-contractual receivables are subsequently measured at fair value using the principles in IPSAS 29 by analogy. Under this approach:
- (a) The present value of the cash flows associated with the receivable is determined at each reporting date using a market rate at that date;
 - (b) Any changes in value since the last reporting date are recognized in surplus or deficit; and
 - (c) Derecognition, presentation, and disclosure requirements are drawn from IPSAS 28-30.
- 7.27 The main issue with this approach is the selection of a market rate. As previously indicated there is unlikely to be a market for many of the transactions arising from non-contractual receivables. The position is compounded because the credit risk associated with a large number of counterparties, which is a feature of non-contractual receivables arising from taxes, fines and penalties might be difficult to assess.
- 7.28 This means that identifying similar financial instruments with the same terms and risk profile is problematic. Under these circumstances reference to a government bond rate is likely to be the only feasible approach.
- 7.29 Some may question whether a fair value approach at subsequent measurement is appropriate for relatively straightforward items that are not held for sale or exchange. Going forward this approach would need to be aligned with proposals for updating IPSAS 28-30.³⁰

Approach 2 – Amortized Cost Approach

- 7.30 Like Approach 1, Approach 2 would apply principles in the IPSASB's literature on financial instruments by analogy. However, under this approach subsequent measurement is at amortized cost, rather than fair value. Under this approach the present value of the cash flows associated with

²⁸ Following consultation the SAASB adopted the cost approach.

²⁹ These jurisdictions include Australia, Canada, New Zealand and United States.

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

the receivable would be determined using the effective interest method and discounted using the original effective interest rate.

- 7.31 In practice the original effective interest rate is likely to be the market rate available at transaction date, because even if interest is levied it is unlikely to be market-related. Under the Amortized Cost Approach, an entity would assess whether there is an indication of impairment, and if such an indication exists, assess the cash flows to determine if the receivable is impaired.
- 7.32 The main advantage of Approach 2 is that it reflects the accounting at subsequent measurement of loans and receivables in IPSAS 29, which are the non-complex financial instruments that non-contractual receivables most obviously resemble. Approach 2 does not require a fair value remeasurement at each reporting date, which might be onerous. However, Approach 2 shares some of the complexities of Approach 1 in terms of identifying a market rate for the effective interest rate at origination. In addition, assessing the cash flows of receivables at reporting date to determine if any of the receivables are impaired could be onerous. Further, maintaining the information on the historical interest rates at origination may be challenging.

Approach 3 – Cost approach

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

Preliminary View 9

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

Non-Contractual Payables

- 7.35 The description of statutory payables mirrors that of statutory receivables in that they are outflows for transactions that do not arise from contracts, but have many of the features of a financial instrument. Such transactions principally include:
- (a) Taxes payable;
 - (b) Appropriations and grants to recipients;

- (c) Repayments of grants; and
- (d) Fines and penalties such as those applied by a regulator.

7.36 Social benefits (which are also non-contractual payables) are not covered by this CP³¹, neither are transactions with the characteristics of insurance contracts.

Current position and potential approaches

7.37 There are no requirements specific to non-exchange expenses in the current IPSASB literature.

7.38 IPSAS 19 requires both measurement at initial recognition and subsequently as “the best estimate of the expenditure required to settle the present obligation at the reporting date.”

7.39 This section outlines four potential approaches. Three approaches were discussed in the South African Accounting Standards Board’s 2012 Discussion Paper 7, *Assets and Liabilities Arising from Non-Contractual Arrangements that Have the Features of Financial Instruments* and the fourth approach uses IPSAS 19 requirements.

7.40 These approaches are:

- (a) Approach 1 – Cost of Fulfillment Approach;
- (b) Approach 2 – Amortized Cost Approach;
- (c) Approach 3 – Hybrid Approach; and
- (d) Approach 3 – IPSAS 19 Requirements.

Approach 1 – Cost of Fulfillment Approach

7.41 This approach requires initial and subsequent measurement as the best estimate of the amount required to settle the liability, using discounted cash flows where appropriate. In accordance with the IPSASB *Conceptual Framework*, the rebuttable presumption is that this is on a cost of fulfillment basis, i.e., the cost that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. There may be very limited occasions where cost of release is the appropriate measure. Cost of release is the amount that a third party would charge to accept the immediate transfer of the liability from the reporting entity. Cost of release will only be relevant when it is both feasible and the most resource efficient approach to settlement of the liability (i.e., when cost of release is lower than cost of fulfillment). The absence of an active market will limit these occasions.

7.42 The advantages of this approach is that it is in accordance with the IPSASB *Conceptual Framework*, relatively straightforward to apply and produces understandable information. Those who consider that the similarities between non-contractual payables and contractual payables can be exaggerated favor it. Those who consider that non-contractual payables and contractual payables are similar question why non-contractual payables are not accounted for in the same way as the financial instruments they resemble.

Approach 2 – Amortized Cost Approach

7.43 Approach 2 mirrors the amortized cost approach for non-contractual receivables. Initial measurement is at fair value and subsequent measurement at amortized cost using the effective interest rate

³¹ The IPSAS has another project on Social Benefits which is why they are excluded from this CP.

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

Approach 3 – Hybrid Approach

7.44 Approach 3 adopts a dual approach. If cash flows from non-contractual payables are certain in timing and amount they should be accounted for under Approach 2. If the cash flows are uncertain in timing and amount they should be accounted for under Approach 1. The rationale for this approach is that non-contractual payables with cash flows that are certain in timing or amount more closely resemble financial instruments as defined in IPSAS than those with cash flows that are uncertain in timing or amount.³²

Approach 4: IPSAS 19 Requirements

7.45 In the absence of specific guidance on the subsequent measurement of non-contractual payables some jurisdictions have been using the current requirements in IPSAS 19. While this approach does not reflect the fact that many non-contractual payables are very similar to financial instruments as defined in IPSASB’s literature, it is relatively straightforward to apply. Therefore, the IPSASB considered it appropriate to include it as an option.

7.46 The IPSASB has not formed a preliminary view on the subsequent measurement of non-contractual payables.

Specific Matter for Comment 7

For subsequent measurement of non-contractual payables do you support:

- (a) Cost of Fulfillment Approach;
- (b) Amortized Cost Approach;
- (c) Hybrid Approach; or
- (d) IPSAS 19 requirements?

Please explain your reasons.

³² Following consultation the SAASB decided not to further develop requirements for non-contractual payables. Non-contractual payables would be accounted for under GRAP 19, Provisions, Contingent Liabilities and Contingent Assets, which is the South African equivalent of IPSAS 19, Provisions, Contingent Liabilities and Contingent Asset.

Advantages and Disadvantages of Revenue Approaches

Approach 1 – Option (a) – Add guidance to IPSAS 23 on assessing whether a transaction is exchange or non-exchange			
Factor	Advantage	Disadvantage	Comment
Consistent with the IPSASB <i>Conceptual Framework</i>	Yes IPSAS 23 is consistent with the elements in Chapter 5 of the <i>IPSASB Conceptual Framework</i> . Adding guidance should not alter this.		
Consistent with other IPSAS	Yes There is no change to recognition and measurement required. Therefore the consistency with other IPSAS does not alter.		
Resolves difficulty with exchange/non-exchange determination for certain revenue transactions	Possibly Added guidance may assist with some of the difficulties in practice of making the exchange/non-exchange distinction to certain revenue transactions and lead to more efficient judgments. This may also lead to improved comparability of accounting.		Even with additional guidance, preparers would still need to exercise judgement in making an exchange/non-exchange determination.
Recognize revenue over more than one reporting period (if applicable)		No Does not change the current requirements of	

Approach 1 – Option (a) – Add guidance to IPSAS 23 on assessing whether a transaction is exchange or non-exchange			
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Factor	Advantage	Disadvantage	Comment
(see Paragraph 4.7)		IPSAS 23 which does not allow the deferral of revenue recognition for transfers that only have a restriction that they must be used within a certain time period.	

Approach 1 – Option (b) – Update IPSAS 23 to address transactions with time requirements (and no other stipulation) via enhanced display/disclosure			
Issue	Advantage	Disadvantage	Comments
Consistent with the IPSASB <i>Conceptual Framework</i>	Yes IPSAS 23 is consistent with the elements in Chapter 5 of the <i>IPSASB Conceptual Framework</i> – changing the presentation would not alter this.		Any display/disclosure proposals would need to be consistent with the presentation chapter in the <i>Conceptual Framework</i> .
Consistent with other IPSAS	Yes There is no change to recognition and measurement required. Therefore the consistency with other IPSAS does not alter.		
Resolves difficulty with exchange/non-exchange determination for certain revenue transactions		No This approach of itself does not address how to make the exchange/non-exchange determination	However, Approach 1 – Option (a) (guidance on exchange/non-exchange transactions) could be combined with this approach which could possibly help address the issue as described under Approach 1 – Option (a).
Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)		No There is a range of possible variants on this approach in terms of combinations of displaying items on the face of the financial statements and/or note disclosures. However there would be no change to recognition and measurement	However, a change in display and/or disclosures may help users understand that certain revenue amounts in the current period are earmarked to funding activity in a future period. This may result in a better understanding of how an entity has performed in the current period

Approach 1 – Option (b) – Update IPSAS 23 to address transactions with time requirements (and no other stipulation) via enhanced display/disclosure			
Issue	Advantage	Disadvantage	Comments
		requirements in IPSAS 23 which does not allow the deferral of revenue recognition for transfers that only have a restriction that they must be used within a certain time period.	and how it may perform in the future.

Approach 1 – Option (c) – Update IPSAS 23 to provide a carve-out for transactions with time requirements (and no other stipulations) which would classify them as conditions rather than restrictions			
Issue	Advantage	Disadvantage	Comment
Consistent with the IPSASB Conceptual Framework		No Reclassifying a time requirement as a condition rather than a restriction does not meet the definition of a liability in the Conceptual Framework because there is no present obligation for an outflow of resources from the entity.	This reclassification would be a 'rule' rather than a 'principle'.
Consistent with other IPSAS		No This reclassification would result in deferring the recognition of revenue which is akin to recognizing a liability that would not be recognized under other IPSAS.	
Resolves difficulty with exchange/non-exchange determination for certain revenue transactions		No This approach of itself does not address how to make the exchange/non-exchange determination	However, Approach 1 – Option (a) (guidance on exchange/non-exchange transactions) could be combined with this approach which could possibly help address the issue as described under Approach 1 – Option (a).

Approach 1 – Option (c) – Update IPSAS 23 to provide a carve-out for transactions with time requirements (and no other stipulations) which would classify them as conditions rather than restrictions			
Issue	Advantage	Disadvantage	Comment
<p>Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)</p>	<p>Yes</p> <p>Because resources received with no other stipulation other than when the resources are intended to be used would be classified as a 'condition'.</p> <p>Revenue would be recognized in the time period the resource provider intended them to be used rather than when receivable.</p>		

Approach 1 – Option (d) – Update IPSAS 23 to address transactions with time requirements (and no other stipulations) via treating them as an ‘other obligation’.			
Issue	Advantage	Disadvantage	Comment
Consistent with the IPSASB Conceptual Framework	<p>Yes</p> <p>The IPSASB <i>Conceptual Framework</i> allows for the recognition of economic phenomena that are not captured by the defined elements. This allowance was included to ensure that in certain circumstances the financial statements provide information that is useful for meaningful assessment of the financial performance and financial position of an entity.</p>		
Consistent with other IPSAS	Not applicable	Not applicable	The option in the Conceptual Framework to recognize an ‘other obligation’ has not been applied in any other IPSAS.
Resolves difficulty with exchange/non-exchange determination for certain revenue transactions		<p>No</p> <p>This approach of itself does not address how to make the exchange/non-exchange determination</p>	However, Approach 1 – Option (a) (guidance on exchange/non-exchange transactions) could be combined with this approach which could possibly help address the issue as described under Approach 1 – Option (a).

Approach 1 – Option (d) – Update IPSAS 23 to address transactions with time requirements (and no other stipulations) via treating them as an ‘other obligation’.			
Issue	Advantage	Disadvantage	Comment
<p>Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)</p>	<p>Yes</p> <p>Because resources received with no other stipulation other than when the resources are intended to be used would be classified as ‘other obligations’.</p> <p>Revenue would be recognized in the time period the resource provider intended them to be used rather than when receivable.</p>		

Approach 1 – Option (e) – Update IPSAS 23 to address transactions with time requirements (and no other stipulations) via recycling through net assets/equity			
Issue	Advantage	Disadvantage	Comment
Consistent with the IPSASB <i>Conceptual Framework</i>	Yes The Conceptual Framework does not link elements to particular financial statements, therefore recognizing revenue in net assets/equity is not in conflict with the IPSASB <i>Conceptual Framework</i> .		However, during the development of the Conceptual Framework, some Board Members had strong reservations about recycling as it would introduce the notion of ‘other comprehensive income’. See CF paragraph BC5.52.
Consistent with other IPSAS	Yes IPSAS 1 does allow for revenue to be recognized in the statement of net assets/equity but only if specifically required by another IPSAS.		However, IPSAS 1 also states that revenue is recognized in the statement of financial performance.
Resolves difficulty with exchange/non-exchange determination for certain revenue transactions		No This approach of itself does not address how to make the exchange/non-exchange determination	However, Approach 1 – Option (a) (guidance on exchange/non-exchange transactions) could be combined with this approach which could possibly help address the issue as described under Approach 1 – Option (a).

Approach 1 – Option (e) – Update IPSAS 23 to address transactions with time requirements (and no other stipulations) via recycling through net assets/equity			
Issue	Advantage	Disadvantage	Comment
<p>Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)</p>	<p>Yes</p> <p>Because resources received with no other stipulation other than when the resources are intended to be used would be recognized when receivable in the Statement of Changes in Net assets/equity and then recycled through the statement of financial performance in the time period the resource provider intended them to be used.</p>		

Approach 2 – Public Sector Performance Obligation Approach (PSPOA)			
Issue	Advantage	Disadvantage	Comment
Consistent with the IPSASB <i>Conceptual Framework</i>	Yes The proposals re revenue and liability recognition are consistent with the concepts in the IPSASB <i>Conceptual Framework</i> .		
Consistent with other IPSAS	Yes The recognition of revenue and liabilities is consistent with other IPSAS.		This approach would also be consistent with the requirements of a future IPSAS that incorporates the requirements of IFRS 15.
Resolves difficulty with exchange/non-exchange determination	Yes There is no requirement to make an exchange/non-exchange distinction.		Decisions would be required as to whether an arrangement contains performance obligations. Determining whether or not there is a performance obligation should be no more onerous than the current requirement to distinguish between a restriction and a condition.
Recognize revenue over more than one reporting period (if applicable) (see paragraph 4.7)	Possibly Deferral of revenue with time requirement restrictions would depend on how far the IFRS 15 requirements were expanded for the public sector.		Deferral of revenue is dependent on the existence of a performance obligation. A time requirement under IFRS 15 would not constitute a performance obligation.

Illustrative Examples

General (non-specific) grant

Fact pattern

A national government (resource provider) agrees to make a transfer of CU10 million to a local government in a socio-economically deprived area. The national government agrees to pay CU10 million on the signing of the binding agreement. The local government (resource recipient) is required under its constitution to undertake various social programs for the benefit of citizens in the community (beneficiaries). The consideration has been provided on the agreement (by both parties) that it will be used to support the general operations of the local government for three years.

Both entities have assessed this transaction as being a non-exchange transaction.

Revenue recognition by local government

Current IPSAS 23 Requirements

The transfer contains a time requirement stipulation that the funds will be used to support the general operations of the local government over a three-year period. Under the current IPSAS 23 requirements, a time requirement is a restriction, and not a condition, therefore, the CU10 million is recognized as revenue when it becomes receivable by the local government (on signing of the agreement).

Approach 1 - The Exchange/Non-Exchange Approach - Update IPSAS 23

The CP identifies four options (1(b) to 1(e)) under Approach 1 for updating IPSAS 23 for transactions with time requirement stipulations:

Option 1(b) – *Require enhanced display/disclosure* – under this option, there would be no change from the current IPSAS 23 recognition requirements for stipulations that are restrictions, i.e., revenue would be recognized immediately when it is receivable by the local government (on signing). Further information could be provided through a note disclosure to the financial statements and/or a new line item in the statement of financial performance and statement of changes in net assets/equity.

Option (c) – *Classify time requirements as a condition* – under this option, the local government would recognize an asset and corresponding liability when the transfer is receivable. As the transfer is used over a three-year period, revenue is recognized in the statement of financial performance and the liability decreases by the equivalent amount over that time.

Option (d) – *Classify transfers with time requirements as other obligations* – this option would result in similar revenue recognition as Option (c). However, the local government would recognize an asset and a corresponding “Other Obligation” when the transfer is receivable (on signing). As the transfer is used over a three-year period, revenue is recognized in the statement of financial performance and the “other obligation” decreases by the equivalent amount over that time.

Option (e) – *Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance* – under this option, the local government would recognize an asset and corresponding item within net assets/equity when the transfer is receivable (on signing). As the

transfer is used over a three-year period, revenue is recognized in the statement of financial performance and the net assets/equity item reverses by the equivalent amount over that time.

Approach 2 - The Public Sector Performance Obligation Approach for Revenue

Step 1 – Identify the binding arrangement – both parties have entered into a binding agreement where the national government agrees to transfer CU10 million to support the general operations of the local government over a three-year period. However, the arrangement contains no promises to deliver distinct services to the national government or to beneficiaries, but does contain a stipulation that the funds are to be used by the local government in general operations over a period of three years.

Step 2 – Identify the performance obligations – the arrangement contains no promises to deliver services that are distinct enough to consider linking the satisfaction of performance obligations and the consideration. While the local government's constitution requires it to undertake various social programs, those requirements are obligations imposed by itself, and not by the national government in this agreement. The national government could not enforce the local government to deliver services to them, or to beneficiaries. Therefore, this arrangement does not contain performance obligations as described in the PSPOA five-step model.

Step 3 – Determine the consideration – the total consideration is CU10 million.

Step 4 – Allocate the consideration – there are no performance obligations to allocate the consideration against.

Step 5 – Recognize revenue – the total revenue of CU10 million would be recognized by the local government when receivable (on signing) because there are no promises to deliver services to the national government or to beneficiaries in the arrangement.

Conclusion

The current IPSAS 23 requirements Approach 1 Option (b) and the PSPOA (Approach 2), produce the same revenue recognition outcomes, in that revenue would be recognized by the local government when the consideration is receivable (on signing). However, the reason for the outcome is different.

Under current IPSAS 23 requirements and Approach 1 Option (b) there is no condition in the arrangement associated with the transfer that leads to the local government recognizing a corresponding liability and revenue is recognized immediately when receivable (on signing). Under the PSPOA, there are no enforceable promises to deliver services to the national government or to beneficiaries, to which consideration can be allocated, so likewise, revenue is recognized when receivable (on signing).

However, under Approach 1 Options 1(c), 1(d) and 1(e), the local government recognizes revenue in the statement of financial performance as the transfer is used in general operations over a three year time period.

Expense recognition for the national government

The fact pattern is the same as described above for the revenue recognition example for a general grant.

The Extended Obligating Event Approach

The Extended Obligating Event Approach uses the principles of IPSAS 23 (e.g., the distinction between restrictions and conditions) but in reverse to apply to non-exchange expenses rather than revenue. Therefore, under the current IPSAS 23 or if an updated IPSAS 23 Approach 1 Option (b) was adopted, the national government will recognize an expense for CU10 million when the funds are payable to the

local government. While the national government recognizes a liability for CU10 million until the funds are paid, it cannot recognize a corresponding asset because there is no unfulfilled condition associated with the transfer imposed on the local government. However, further information could be provided through a note disclosure to the financial statements and/or a new line item in the statement of financial performance and the statement of changes in net assets/equity.

Under an updated IPSAS 23:

Option (c) - the national government would recognize a liability and corresponding asset when the transfer was payable (on signing). As the transfer was used over the three-year period an expense would be recognized in the statement of financial performance and the asset decreases by the equivalent amount over that time

Option (d) - this option would result in similar expense recognition as Option (c). However, the national government would recognize a liability and a corresponding "other resource" when the transfer was payable (on signing). As the local government uses the transfer over the three-year period, and expense is recognized in the statement of financial performance and the "other resource" decreases by the equivalent amount over that time.

Option (e) - under this approach the national government would recognize a liability and corresponding item within net assets/equity when the transfer was payable (on signing). As the transfer was used over the three-year period an expense would be recognized in the statement of financial performance and the net assets/equity item reverses by the equivalent amount over that time.

Public Sector Performance Obligation Approach

Step 1 – Identify the binding agreement – as described in Step 1 for revenue, both parties have entered into a binding agreement where the national government agrees to transfer CU10 million to the local government when the agreement is signed.

Step 2 – Identify the performance obligations – as described in Step 2 for revenue, the arrangement contains no promises to deliver services to the national government or to beneficiaries that are distinct enough to link the satisfaction of performance obligations and the consideration in the agreement. Therefore, this arrangement does not contain performance obligations as described in the PSPOA five-step model.

Step 3 – Determine the consideration – the total consideration is CU10 million.

Step 4 – Allocate the consideration – as described in Step 4 for revenue there are no performance obligations to allocate the consideration against.

Step 5 – Recognize the expense – the expense of CU10 million would be recognized by the national government when the transfer is payable (on signing).

Conclusion

Depending on how IPSAS 23 is updated will determine if the accounting outcomes are the same.

Under The Extended Obligating Event Approach using the current IPSAS 23, and an Updated IPSAS 23 Option (b) principles (in reverse), and the PSPOA the national government recognizes an expense for the CU10 million when it is payable (on signing) to the local government. However, the reason for the outcome is different. Under The Extended obligating event approach, there is no condition. Under the PSPOA there are no enforceable promises to deliver services to the national government or to beneficiaries, to which consideration can be allocated.

However under The Extended Obligating Event Approach using Updated IPSAS 23 Approaches 1 Options 1(c), 1(d) and 1(e) the national government recognizes an expense in the statement of financial

performance as the transfer is used (by the local government) in general operations over a three year time period.

A specific grant

Fact pattern

- A national government (resource provider) signs a binding funding agreement to make a cash transfer of CU5 million to a government health services entity (resource recipient), who provides health services to the public (beneficiaries). The funding is payable on signing of the agreement. The consideration is provided upfront to enable the government health services entity to finance the delivery of a free vaccination program to the public.
- The standard cost of each vaccination, including the cost of administering is CU5. The funding agreement requires the administration of 1 million vaccinations.
- The government health services entity is required to report to the national government on a monthly basis as to the progress of the vaccination program. Progress is measured by the number of vaccinations administered in a month.
- The funding agreement does not specify the return of consideration to the national government in the event that not all the vaccinations are administered. However, the funding agreement provides the national government with an ability to enforce the health services entity to administer all the vaccinations to members of the public by means other than imposing a return obligation (e.g., by reducing future funding for similar programs).
- Both entities have assessed this transaction as being a non-exchange transaction.

Recognition of revenue by the government health services entity

Current IPSAS 23 requirements

This funding agreement contains a stipulation that the consideration is to be used for the administration of 1 million vaccinations. The stipulation is a restriction, rather than a condition because the funding agreement does not impose a return obligation on the government health service entity in the event of a breach.

Therefore, IPSAS 23 requires the recognition of revenue by the government health services entity when the CU5 million is receivable, which in this example is when the funding agreement is signed.

DR Cash	CU5 Million
CR Revenue	CU5 Million

Approach 1 – The Exchange/Non-Exchange Approach Updated IPSAS 23

There are no identified changes to IPSAS 23 that would impact the recognition of revenue by the government health services entity and the current IPSAS 23 accounting would apply.

Public Sector Performance Obligation Approach – application of 5-step process

Step 1 – Identify the binding arrangement — the funding agreement establishes a binding arrangement where both parties have enforceable rights – the national government has the ability to enforce the health services entity to deliver the vaccination program and the health services entity has the ability to enforce the funding under the arrangement.

Therefore when the funding arrangement is signed the national government has a present obligation to the government health services entity and therefore the national government recognizes a liability of CU5 million.

Because there is no return obligation in the agreement, the stipulation to administer 1 million vaccinations is a restriction not a condition, therefore the national government recognizes an immediate expense.

DR Expense CU5 Million

CR Cash CU 5 Million

An expense is recognized when the funding becomes payable, which is when the funding agreement is signed.

(Potential revisions to update IPSAS 23 under Approach 1 – The Exchange/Non-Exchange Approach – Update IPSAS 23 for revenue, would not affect the current IPSAS 23 requirements for this example.)

The Public Sector Performance Obligation Approach

Step 1 – Identify the binding agreement – as described in Step 1 for revenue the funding agreement establishes a binding arrangement where both parties have enforceable rights.

Step 2 – Identify the performance obligations – as described in Step 2 for revenue, there are performance obligations in this arrangement because administering each vaccination is considered a promise to deliver a distinct service therefore each vaccination is a performance obligation .

Step 3 – Determine the consideration – the total consideration for the delivery of the vaccination program is CU5 million.

Step 4 – Allocate the consideration – the consideration of CU5 is allocated to each vaccination administered.

Step 5 – Recognize the expense – As each vaccination is administered, the national government recognized an expense. In this example, the national government receives monthly reports on the number of vaccinations administered, and accepts this as evidence of fulfillment of performance obligations each month. The national government recognizes an expense for the number of vaccinations administered in each month @ CU5 per vaccination.

These are the journal entries that would apply

DR Asset CU 5 Million

CR Cash CU 5 Million

A liability is recognized when the funding becomes payable, which is when the funding agreement is signed, and a corresponding asset is also recognized to reflect the health services entity's unfulfilled performance obligations that are enforceable.

DR Expense CU XX

CR Asset CU XX

An expense is recognized as vaccinations are administered to the public and performance obligations are fulfilled at CU5 per vaccination.

Conclusion

The Extended Obligating Event Approach and the PSPOA result in different expense recognition outcomes.

Under The Extended Obligating Event Approach, the national government recognizes a liability and an expense for the full amount of funding when the funding agreement is signed and the funding becomes payable. As the funding arrangement does not impose a return obligation (i.e., a condition) on the government health services entity an expense is recognized immediately.

However, under the PSPOA, there are enforceable performance obligations imposed on the government health service entity to administer vaccinations. When the funding agreement is signed the national government will recognize a liability and a corresponding asset – being the health services entity’s unfulfilled performance obligation to administer the vaccinations that are enforceable by the national government.

As the vaccinations are administered the national government recognizes an expense each month and reduces the asset by the equivalent amount until delivery of the vaccination program is completed.

Multi-year research grant

Fact pattern

- A national government and a research university enter into a binding funding agreement whereby the national government will provide the research university with a grant of CU25 million to undertake research into the effects of restrictive diets on general health.
- The grant is made on the basis of a detailed project plan prepared by the research university which proposes five milestones.
- Each of these milestones requires research to be published annually on one of the five different restrictive diets selected for the study.
- Further, as specified in the funding agreement, at the end of each milestone all research findings (both positive and negative) are to be published in a recognized academic journal.
- The funding agreement states the grant will be paid each year for 5 years in equal instalments (CU5 million per year). Each installment is payable at the start of each year. The first tranche is payable when the agreement is signed.

Year	Publish	Paid
Year 1 Start		CU5 Million
Year 1 End	Report 1	
Year 2 Start		CU5 Million
Year 2 End	Report 2	
Year 3 Start		CU5 Million
Year 3 End	Report 3	
Year 4 Start		CU5 Million
Year 4 End	Report 4	
Year 5 Start		CU5 Million
Year 5 End	Report 5	

- Payment of the 2nd, 3rd, 4th and 5th tranches is dependent on the research university publishing the results from the completion of the previous year's milestone.
- Any intellectual property arising from the research belongs to the research university.
- Any unused consideration is required to be returned to the government. If the University uses the consideration on another project and does not use it for the research as detailed in the original project plan, the consideration is also required to be returned to the government. Also if the University does not publish the research findings, the consideration must be returned.
- Both entities have assessed this transaction as being a non-exchange transaction.

Recognition of revenue for the research university

Current IPSAS 23 requirements

The funding agreement contains both an obligation to use the funds for a particular purpose and a return obligation, therefore a condition exists. Accordingly, under IPSAS 23, the research university recognizes an asset and corresponding liability for the first tranche of CU5 million when receivable (at the start of the year). When the results of the first milestone are published, the university recognizes revenue of CU5 million

and derecognizes the corresponding liability. At the same time a new asset and corresponding liability for the second tranche of CU5 million would be recognized and so forth until all 5 years of milestones have been achieved.

The Exchange/Non-Exchange Approach – Update IPSAS 23

While the delivery of research findings will occur over a five-year time period, there is no time restriction stipulation imposed in the agreement.

Therefore, there are no proposed changes to the current IPSAS 23 that would impact the recognition of revenue in this example. Therefore the current IPSAS 23 revenue recognition requirements would continue to apply.

Approach 2 – Public Sector Performance Obligation Approach for Revenue

Step 1 – Identify the binding arrangement – the arrangement establishes enforceable rights and obligations on both parties and requires that consideration is used as specified to undertake research and to deliver those research findings. In this example, enforceability is demonstrated by the condition that consideration is returned to the national government in the event of a breach and entitlement to a subsequent milestone is conditional on the publishing of research from the previous milestone. The arrangement is therefore considered to be a binding agreement.

Step 2 – Identify the performance obligations – the publishing of research findings each year reflects promises to deliver distinct services. Therefore, each research milestone achieved combined with the publishing of the results of the research is a performance obligation.

Step 3 – Determine the consideration – the total consideration for publishing all of the five research findings is CU25 million.

Step 4 – Allocate the consideration – the total consideration is allocated to each performance obligation - CU5 million per milestone achieved/research published.

Step 5 – Recognize revenue – revenue of CU5 million is recognized at the results of the research for each restrictive diet is published.

Conclusion

Revenue is recognized in the same way irrespective of whether the current IPSAS 23 requirements, or the PSPOA is applied, because the agreement includes a return obligation (i.e., a condition) under IPSAS 23 and performance obligations as described in the PSPOA five-step model.

Potential updates to IPSAS 23 under Approach 1 – *The Exchange/Non-Exchange Approach – Update IPSAS 23* would not affect the current IPSAS 23 requirements for this example.

Recognition of expense for the national government

The fact pattern is the same as described in the revenue recognition example for a multi-year research grant above.

The Extended Obligating Event Approach

When the funding agreement is signed, the national government has a present obligation to pay the first tranche of CU5 million to the university, and therefore, the national government recognizes a liability for CU5 million (once the funds have been transferred to the research university the liability would be derecognized).

Because the funding agreement contains a return obligation imposed on the research university (i.e., a condition) a corresponding asset is also recognized by the national government to reflect the university's unfulfilled condition that can be enforced by the national government. This is an asset because it is considered a resource controlled by the national government until the condition is fulfilled and it was a result of a past event.

Once the condition has been fulfilled, and the first research finding is published by the university, the national government recognizes an expense for CU5 million and decrease the initial asset it recognized by the same amount.

When the first milestone is achieved, and the first research finding published, the national government now has a present obligation to pay the second tranche of funding, and therefore, recognizes another liability for the second tranche of CU5 million. As is the case with the first tranche, because the funding agreement contains a return obligation imposed on the research university (i.e., a condition), a corresponding asset is also recognized by the national government to reflect the university's unfulfilled condition that can be enforced by the national government. Once the condition has been fulfilled with the second research publication, the national government recognizes an expense for CU5 million and decreased the second asset by the same amount.

This pattern of expense recognition continues as each milestone is achieved and each research finding is published.

Public Sector Performance Obligation Approach

Step 1 – Identify the binding agreement – as described in Step 1 for revenue the funding agreement establishes enforceable rights and obligations on both parties and requires the research university to undertake a research program as agreed in a detailed project plan.

Step 2 – Identify the performance obligation – as described in Step 2 for revenue, each research milestone is a performance obligation.

Step 3 – Determine the consideration – the total consideration for the arrangement is CU25 million.

Step 4 – Allocate the consideration – as described in Step 4 for revenue the total consideration of CU25 million is allocated to each performance obligation fulfilled – CU5 million per milestone achieved/research published.

Step 5 – Recognize the expense – an expense of CU5 million is recognized as the results of the research for each restrictive diet is published.

Conclusion

Recognition of expense is the same under The Extended Obligating Event Approach and the, PSPOA.

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