EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

NOTE: New Wi-Fi Access Code:

Network name: XRB_GUEST

Access code: kq4mnlxd

(lower case 'L' not figure 1)

Board Meeting Agenda

Friday 24 November 2017
External Reporting Board, Level 7, 50 Manners Street, Wellington
External Reporting Board, Level 12, 55 Shortland Street, Auckland

Est Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
Preliminary					
9.00 am	**1**	**Welcome and Introduction** Apologies			
B: PUBLIC SESSION					
PBE Item for Consideration					
9.05 am	**2**	**IPSASB CP *Accounting for Revenue and Non-Exchange Expenses***	(ALH/AH)		
	2.1	Cover Memo	Consider	Paper	
	2.2	Draft comment letter	Consider	Paper	
	2.3	IPSASB CP *Accounting for Revenue and Non-Exchange Expenses*	Note	Paper	
10.30 am		*Morning tea*			
10.45 am	**2**	**IPSASB CP *Accounting for Revenue and Non-Exchange Expenses* (continues)**	(ALH/AH)		
12.00 pm		*Finish*			

Next NZASB meeting: Thursday 14 December 2017

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	14 November 2017
To:	NZASB Members
From:	Aimy Luu Huynh and Anthony Heffernan
Subject:	**IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses***

Purpose and introduction[1]

1. The purpose of this paper is to seek Board feedback on the draft comment letter of the IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP).

2. The Working Group will have their third meeting on the 21st November and has been presented with the same draft comment letter as the Board in agenda item 2.2. We have requested the Working Group to focus on the overview of the NZASB's proposed framework for the recognition approaches for revenue and non-exchange expenses and the associated preliminary views (PVs) and specific matters for comment (SMCs). We will provide a verbal update of the Working Group meeting at the Board meeting.

3. The IPSASB published the CP in August. Comments are due to the NZASB by 22 November 2017 and to the IPSASB by 15 January 2018. We will provide a verbal update on any submission received at the Board meeting.

4. For Board members who are unable to attend the meeting on the 24th November, in Dropbox we have included a Word version of the draft comment letter should any Board members want to provide marked-up changes and feedback. Staff would appreciate receiving any feedback on the draft comment letter via email (aimy.luuhuynh@xrb.govt.nz) by 22 November 2017.

Summary of staff recommendations

5. We recommend that the Board:

   (a) PROVIDES feedback on the draft comment letter (agenda item 2.2) of the IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*; and

   (b) NOTES the next steps of the project.

1 This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Structure of the memo

6. The remainder of this memo is set out as follows:

   (a) Draft comment letter;

   (b) Next steps; and

   (c) Appendix: Summary of the Board's views.

Draft comment letter

7. A draft comment letter is provided as agenda item 2.2. The draft comment letter includes feedback from the Board, Working Group and outreach activities.

8. In agenda item 2.2 we have indicated by an asterisk * the PVs and SMCs that relate to the key areas of focus the Board had agreed to provide detailed comments on. The asterisks will be removed in the final comment letter.

9. In the draft comment letter there are questions, notes in some for some PVs and SMCs to assist the Board in developing a response.

Next steps

10. At the December NZASB meeting, we will provide the Board with an updated draft comment letter that incorporates the Working Group and Board's feedback.

11. Depending on the feedback from the December Board meeting, we may need a sub-committee to complete a final review and approval of the comment letter before it is submitted in January 2018. We can decide on the sub-committee at the December meeting.

Attachments

Agenda item 2.2: NZASB draft comment letter on IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Agenda item 2.3: IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

APPENDIX: Summary of the Board's views

1. This appendix provides a summary of the Board's views on the CP discussions to date.

2. At the NZASB meeting in September the Board agreed:

   (a) the areas of focus for the Board's comment letter are the proposed approaches for the recognition of revenue and non-exchange expense; and

   (b) the other topics covered in the CP may be important to our constituents but due to the short comment period the Board's comment letter will have high-level comments.

3. At the NZASB meeting in October the Board provided feedback on the revenue recognition approaches proposed in the CP. The Board agreed:

   (a) the proposed framework for recognition of revenue transactions in the public sector and not-for-profit sector should be classified as those with performance obligations or those without performance obligations rather than exchange or non-exchange distinction;

   (b) revenue transactions in Category C[2] should be accounted for using the Public Sector Performance Obligation Approach (PSPOA), which is based on IFRS 15 *Revenue from Contracts with Customers* adapted for the public sector;

   (c) revenue transactions in Category A[3] should be accounted for under a residual standard (or a residual section of the standard, if there is only one standard on revenue), which could be an updated IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers);*

   (d) there is a wide spectrum of revenue transactions in Category B[4]. The scope of Category B transactions that could be accounted for using the PSPOA will depend on how the IPSASB define key factors such as enforceability and performance obligation;

   (e) revenue transactions in Category B where there are enforceable performance obligations to transfer goods or services to other parties (including transactions involving transfers to beneficiaries and for subsidised goods or services) should be accounted for using the PSPOA; and

   (f) revenue transactions in Category B where there are stipulations over use (but do not necessarily involve the transfer of goods or services to the resource provider or beneficiary) or only time requirements could be accounted for under an updated IPSAS 23 approach using either the presentation option or the other comprehensive revenue and expense with recycling option.

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2 Revenue transactions within the scope of IFRS 15.

3 Revenue transactions with no performance obligations or stipulations over use.

4 Revenue transactions with performance obligations or stipulations but do not have all the characteristics of a transaction within the scope of IFRS 15.

4. The Board agreed an overview of the Board's proposed framework for revenue recognition in the public sector (as noted above) should precede the responses to the preliminary views and specific matters for comment. The overview will set the scene for the IPSASB on the Board's thinking and rationale for the responses to the preliminary views and specific matters for comment. The responses to each preliminary view and specific matter for comment should be linked back to the overview where appropriate.

5. At the NZASB meeting in November the Board provided feedback on the non-exchange expense recognition approaches proposed in the CP. The Board noted:

   (a) the CP has not provided a conceptual basis for the recognition of an asset if there is a return condition under the Extended Obligating Event Approach;

   (b) that for the recognition of non-exchange expense the first question to ask is when does an obligating event arises. The guidance on an obligating event can be drawn from IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* and the IPSASB's *Conceptual Framework*. The recognition of an asset will be subject to a number of factors;

   (c) that non-exchange expense transactions with enforceable performance obligations to transfer goods/services to the resource provider or beneficiaries could be accounted for using a simplified public sector performance obligations approach;

   (d) that there is not much conceptual difference between the transactions in the Exposure Draft 63 *Social Benefits* and universally accessible services and collective services so the accounting for these expenses should be consistent; and

   (e) that non-exchange expense transactions with no performance obligations but with stipulations over use could be recognised when the obligating event arises with a presentation option or other comprehensive revenue and expense with recycling option to address stipulations.

XX January 2018

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA
Submitted to: www.ifac.org

Dear John

Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Thank you for the opportunity to comment on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). The CP has been exposed in New Zealand and some New Zealand constituents may have made comments directly to you.

[The main points on the CP to be emphasised here once detailed responses have been finalised.]

Our recommendations and responses to the Preliminary Views and Specific Matters for Comment are set out in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Aimy Luu Huynh (aimy.luuhuynh@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook

Chair – New Zealand Accounting Standards Board

Notes for the Working Group and Board – draft comment letter

- The Board agreed an overview of our proposed revenue framework should precede the responses to the Preliminary Views (PVs) and Specific Matters for Comment (SMC). The responses to each PV and SMC should be linked back to the overview where appropriate.
- The draft responses have not repeated the overview unless it is a key point that should be re-emphasised.
- For non-exchange expenses, the same structure as revenue has been applied.
- The PVs and SMCs marked by an asterisk * relate to key areas the Board previously agreed to provide detailed comment on. For the other PVs and SMCs, the Board agreed staff should develop high-level comments only. The asterisks will be removed in the final comment letter.
- There are questions and notes in some PVs and SMCs to assist the Board in developing a response.
- The draft responses are based on the feedback from the Board, Working Group and outreach activities.

APPENDIX 1 Overview of the NZASB's proposals

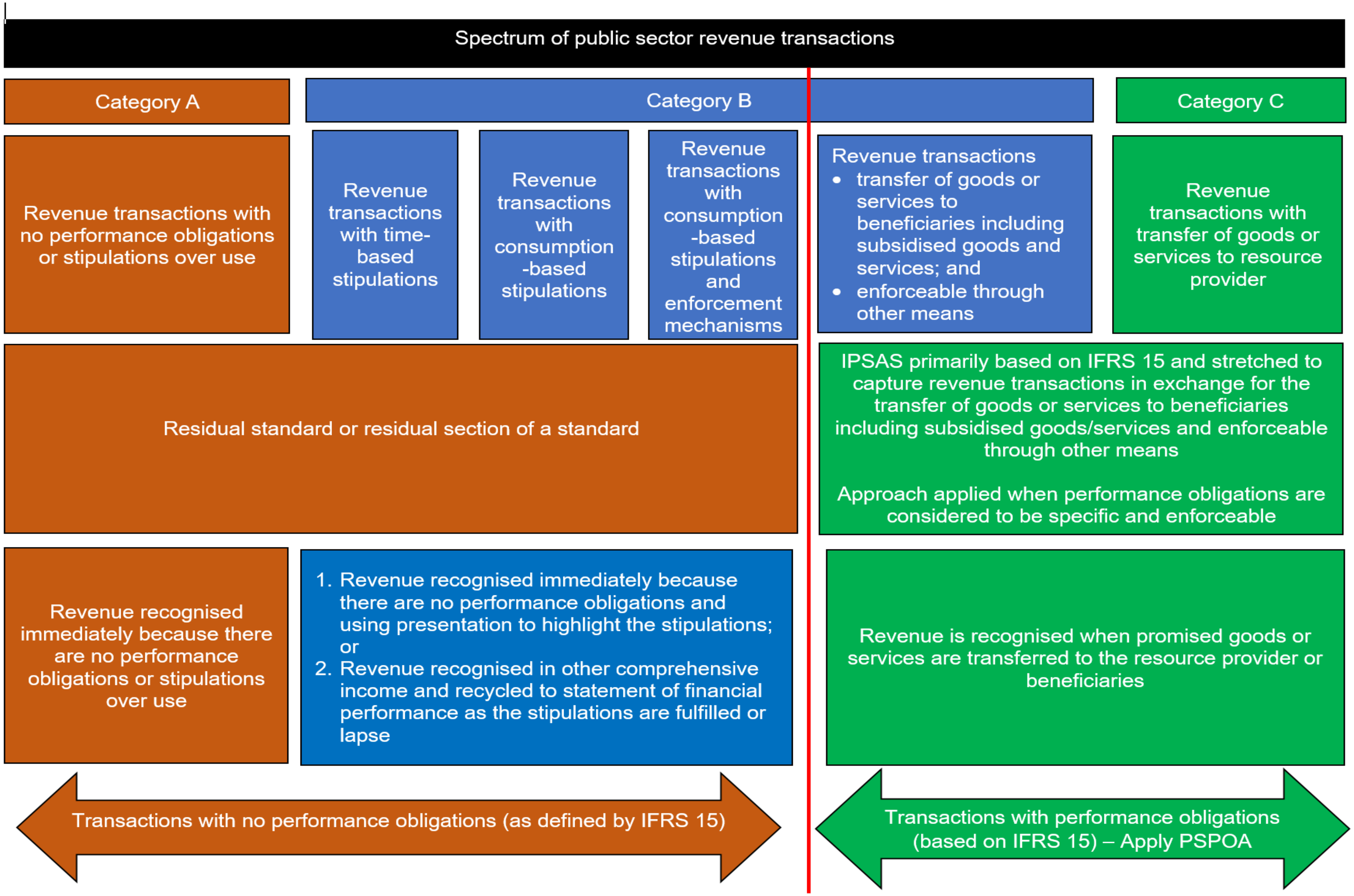
Revenue

The NZASB has considered the proposed revenue recognition approaches in the CP and is of the view that these proposals do not fully capture all the revenue transactions in the public sector and address all the revenue issues identified in the CP. The CP has focused on revenue transactions with performance obligations, or revenue transactions without performance obligations but with time requirements. There are a number of revenue transactions without performance obligations but with other stipulations which the CP has not considered. For example, consumption-based resources such as grants to fund the salary costs of an entity.

The NZASB has developed a proposed framework for revenue transactions in the public sector which distinguishes between revenue transactions with performance obligations and those without performance obligations, rather than using the exchange or non-exchange distinction.

Diagram 1 below provides an overview of the NZASB's proposed framework for revenue transactions in the public sector.

Diagram 1 NZASB's proposed framework for revenue



We understand the three categories of revenue transactions (Categories A, B, and C) have been used to discuss the proposed revenue recognition options within the CP. However, there is a wide spectrum of revenue transactions in the public sector with varying forms of performance obligations and stipulations; therefore, establishing clear boundaries for when different revenue recognition approaches apply will be important for drafting exposure drafts (EDs) and standards. The boundary for different revenue recognition approaches will largely depend on how far the IFRS 15 *Revenue from Contracts with Customers* concept of a "performance obligation" is stretched to reflect the public sector context[1].

Our proposed framework is based on the Public Sector Performance Obligation Approach (PSPOA). It is therefore based on IFRS 15, adapted for the public sector context, and stretched where possible to include as many revenue transactions as feasible, subject to maintaining consistency with the definition of a liability in the IPSASB *Conceptual Framework* and ensuring that those transactions within the scope of the PSPOA are the type of transaction to which the revenue recognition model in IFRS 15 can be applied.

A framework based on a distinction between transactions with or without performance obligations could result in fewer scope debates and more meaningful revenue recognition discussions.

We have explained our proposals for the three categories of revenue transactions in order of the preliminary views (PV) and specific matters for comment (SMC) in the CP below.

Category C

Transactions in our Category C are the same as proposed in the CP, being enforceable agreements with performance obligations to transfer goods/services to the resource provider. Therefore, we agree revenue transactions in Category C should be accounted for using the proposed PSPOA.

Category A

Transactions in our Category A are the same as proposed in the CP, being those with no performance obligations or stipulations. Under our proposed framework, these transactions would be accounted for in a residual standard (or section of a standard), based on the applicable parts of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and updated to address practice issues relating to these types of transactions, as discussed further in our response to PV2 and SMC1.

Category B

There is a wide spectrum of revenue transactions in Category B. The scope of Category B transactions that could be accounted for using the PSPOA will depend on how the IPSASB defines key factors such as enforceability and performance obligations.

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[1] For the purpose of this comment letter, we have developed a working definition of a public sector performance obligation. Our proposed definition is:

an enforceable agreement with the resource recipient to deliver specific goods or services either to the resource provider or beneficiaries.

Our view of performance obligations requires the transfer of resources to an external party in an enforceable and sufficiently specific agreement. This is not the same as IPSAS 23's broad notion of a performance obligation as a duty to act or perform in a certain way. Our proposed framework is based on the definition of a liability in the Conceptual Framework, whereby for a liability to exist, the obligation must require an outflow of resources. Hence, our proposed framework would remove the current distinction between conditions and restrictions, as such a distinction would not be relevant. Under our proposed framework, arrangements with consumption-based stipulations, either with or without return conditions (and/or other enforcement mechanisms), would not result in a deferral of revenue. This is because using resources internally does not involve an outflow of resources. In other words, a deferral of revenue would arise if there is an enforceable and specific agreement to transfer goods or services to other parties, including beneficiaries i.e. there are performance obligations as defined under the PSPOA. Thus, revenue would be deferred only if there is an obligation that satisfies the definition of a liability.

<u>Transactions currently in IPSAS 23</u>

We have identified transactions which currently fall within the scope of IPSAS 23 that could be accounted for using the PSPOA if they have performance obligations and the following characteristics.

- Enforceable through other means

  We agree with the CP's view that enforceability in a binding arrangement would need to go beyond the existence of a return obligation and include other enforcement mechanisms where the transferor can take remedies in the event of non-fulfilment of a performance obligation. An enforceable binding arrangement can be enforced through legal or equivalent means.

  Therefore, some transactions with no explicit return condition, but which are enforceable through other means, could be accounted for under the PSPOA. We comment further on this point in our response to PV1.

- Transfer of goods or services to beneficiaries

  Based on the current IPSAS literature, one interpretation of the definition of exchange and non-exchange transactions is that where the transfer of goods or services is to a beneficiary (rather than the resource provider), the transaction is a non-exchange transaction. There is no exchange of approximately equal value between the resource recipient and the resource provider.

  Consistent with our earlier comments about the definition of a liability, in our view, it should not matter whether the entity is required to transfer goods or services back to the resource provider or to beneficiaries – either way, there is a transfer of resources to another party. We consider that the PSPOA should capture revenue transactions arising from three party arrangements (resource provider, resource recipient and resource beneficiary).

  Therefore, we agree with the CP that revenue transactions in Category B where the goods or services are transferred to beneficiaries should be accounted for using the PSPOA.

- Subsidised goods or services

  Again, consistent with our earlier comments about the definition of a liability, in our view, it should not matter whether the arrangement involves the transfer of goods or services at a subsidised price – irrespective of whether a price subsidy exists, a performance obligation exists when the entity is obliged to transfer goods or services to another party.

  Therefore, transactions that transfer goods or services to beneficiaries with a subsidy or on?? a cost-recovery basis can be accounted for under the PSPOA.

<u>Other issues for consideration</u>

There are a range of issues that would need to be addressed in developing the PSPOA. These are discussed in our response to PV1.

<u>Transactions with time-based stipulations</u>

For revenue transactions with no performance obligations or stipulations over use other than time requirements, we considered two options which could be appropriate. We explain these two options below. Later, we provide our views on which option is our preferred option.

1. Presentation

   This option is the same as Approach 1 "The Exchange/Non-Exchange – Update IPSAS 23", option (b) proposed in the CP. Revenue is recognised when resources are received or receivable, but with enhanced presentation to highlight the stipulations over use. This option stays true to the definitions of elements in the Conceptual Framework and gives an entity a method of communicating its performance story to the users of financial statements. This option would help to educate users to focus not only on the surplus or deficit (the "bottom line") but to look at what makes up the surplus or deficit.

   We have provided additional comments on how this presentation option could be applied in our response to SMC3.

2. Other comprehensive income

   This option is an extension of Approach 1, option (e) proposed in the CP. Our option would require the IPSASB to develop principles for presenting revenue and expenses outside of surplus or deficit, similar to the presentation of other comprehensive income (OCI) in IFRS® Standards (for the reasons explained below). This option would be appropriate only for transactions where there are resources with clear stipulations imposed by the resource provider. This is because the stipulations need to be sufficiently clear to enable the entity to determine when the stipulation has been met or has lapsed. Also, we do not consider it appropriate to apply this approach to self-imposed stipulations on the use of funds.

   On initial recognition, the recipient would recognise the inflow of resources in other comprehensive income within the statement of financial performance and then take those resources to a separate reserve within net assets/equity. As the resources are used over the specified time, other comprehensive income is recycled to revenue. Our suite of PBE

Standards already has the concept of OCI, which we refer to as "other comprehensive revenue and expense". Before introducing our suite of PBE Standards based on IPSAS, our public sector entities had previously applied New Zealand equivalents to IFRS Standards, including OCI, so we carried forward OCI into our suite of PBE Standards.

This option keeps the balance sheet consistent with the definitions of elements in the IPSASB Conceptual Framework. The resources will still be recognised in the statement of financial performance when received or receivable but through a separate section called OCI or an equivalent.

This option overcomes the strict principle in IPSAS 23, which does not permit resources with no conditions to be recognised over time. This approach acknowledges the stipulations placed on the resources as this is shown clearly in the statement of financial performance and is more likely to result in revenue being included in surplus or deficit in the same periods in which the resources are used.

This option would work only if the IPSASB develops principles for what can be recognised in OCI and OCI is recycled to surplus or deficit. This option would not work if the resources are recognised directly in net assets/equity and there is no recycling. If the resources are recognised directly in net assets/equity with no recycling, this is less transparent and potentially misleading, as it is presenting a message that the recipient is no better off in terms of financial performance, which does not reflect the substance of the transaction.

The IPSASB will need to consider how far to take this OCI approach for transactions where the stipulation is not for a limited period of time, such as permanently restricted assets such as land. Under this option, these resources could permanently be in OCI because of the permanent restriction.

Questions for the Board

Should the OCI option be extended to transactions with permanently restricted assets?

If yes, how would recycling to the statement of financial performance be applied?

<u>Transactions with consumption-based stipulations but without return obligations or other enforcement mechanisms</u>

We consider a condition over use is substantially the same as a time requirement – there is no outflow of resources to another party (so no liability exists) but the existence of the stipulation results in similar issues as for transactions with time-based stipulations, and hence a similar accounting treatment should apply. Therefore, under our proposed framework, revenue is recognised when received or receivable, using either the presentation option or the OCI option.

<u>Transactions with consumption-based stipulations with return obligations or other enforcement mechanisms</u>

We consider a condition over use with return obligations or other enforcement mechanisms is substantially the same as a time-based stipulation or a consumption-based stipulation without return obligations. The return of funds to the resource provider is required only if and when the entity has failed to satisfy the stipulation, which typically is within its control. As such, a liability arises only if and when the entity has failed to meet the stipulation and must return the funding.

Therefore, for transactions with consumption-based stipulations that also have return conditions or other enforcement mechanisms, revenue is recognised when received or receivable, using either the presentation option or OCI option.

Our preference on whether to use the presentation option or OCI option

In suggesting the presentation option and OCI option, the NZASB notes that there are issues in practice in providing users of financial statements with a clear picture of the entity's performance for a particular period in situations in which the entity has received funding with stipulations attached. Hence, the NZASB considered how to present revenue arising from such funding in a way that assists the entity in telling its performance story, but without creating new problems associated with deferring revenue in the statement of financial position when no liability exists.

The majority of NZASB members prefer the presentation option, with a minority preferring the OCI option. In addition, some NZASB members that prefer the presentation option would also accept the OCI option if there are significant difficulties in developing the presentation option.

Question for the Board
Should the OCI option be mandatory or optional?

Non-exchange expenses

Introduction

The NZASB has considered the CP proposed approaches for the recognition of non-exchange expense and felt the proposals do not fully address the accounting for all types of non-exchange expense transactions and the related recognition issues that arise in the public sector. Some types of transactions are not discussed. For those types of transactions that are discussed, in our view, the analysis is insufficient, both in terms of the rationale provided and the consideration of alternative views.

We first explain our concerns with the proposals in the CP and then our proposed approach.

The proposed approaches for the recognition of non-exchange expenses in the CP appear to have been developed based on applying the proposed CP revenue recognition approaches in reverse (a mirror approach). We note the IPSASB is of the view that it is important for the approach in a non-exchange expense standard for grants, contributions, and other transfers to mirror the approach adopted for an equivalent revenue transaction.[2]

While we agree that it is important to be consistent when dealing with similar accounting issues (which we comment on further later), that does not mean that a conclusion reached in one context applies in a different context.

The recognition of non-exchange expenses from a resource provider context should encompass a separate set of considerations and recognition issues in contrast to the recognition of revenue by the resource recipient. The key issues discussed in the CP relating to the recognition of revenue are primarily concerned with determining when revenue should be recognised, once it has already been established that the entity has received or is entitled to receive the funding concerned. In contrast, the key issues relating to the recognition of non-exchange expenses are primarily concerned with determining when the resource provider has incurred a liability to transfer resources to another party, which involves identifying when the entity has a present obligation arising from a past event. Furthermore, it cannot be assumed that the pattern of revenue recognition by the resource recipient should, in concept, mirror the pattern of expense recognition by the resource provider.

We therefore consider that applying a mirror approach is not an appropriate starting point for developing a framework for non-exchange expense recognition. Nevertheless, once an approach for non-exchange expense recognition has been developed from the context of the resource provider, we feel it will be useful for the IPSASB to consider whether there is consistency between the proposed revenue and non-exchange expense recognition approaches. This ensures that any differences in outcomes can be explained and reflect the different circumstances in each case, rather than any inconsistency in the conceptual rationale for conclusions reached on similar or related issues.

We also noted that the CP discussion on the recognition of non-exchange expenses in relation to transactions with no performance obligations mainly focuses on the accounting for universally accessible services and collective services. It is not clear how the CP proposes to account for other

[2] Paragraph 6.42 of the CP

non-exchange expense transactions in which the resource provider has imposed stipulations (but no performance obligations), such as stipulations on when the funding must be spent (time restrictions) or other restrictions or conditions over use.

Furthermore, we note PV7 states that the IPSASB is of the view that a PSPOA for non-exchange expense transactions should be applied to grants, contributions and other transfers which contain either performance obligations or stipulations. There is limited discussion on why the IPSASB consider that a PSPOA is appropriate for non-exchange expense transactions with stipulations over use but no performance obligations, and how a PSPOA would be applied to these transactions with no performance obligations.

We consider that additional standards-level requirements are needed to provide guidance on determining when the obligating event that leads to liability and expense recognition arises for the wide range of non-exchange expense transactions that occur in the public sector.

For these reasons, and others as discussed below and in our response to SMCs and PVs, we feel that further analysis and discussion of a range of issues relating to non-exchange expense recognition is necessary to develop guidance on these matters.

NZASB's proposed framework for expense recognition

The NZASB has developed a proposed framework for the recognition of various types of expenses in the public sector that appear to be in the scope of the CP.

Under this proposed framework for expense recognition, we do not support the development of a standard only for non-exchange expenses. This would result in the creation of an arbitrary distinction between exchange and non-exchange expenses, which already has been problematic in the context of revenue. Instead, we suggest the IPSASB considers developing a simplified PSPOA for all expense transactions with performance obligations, excluding expense transactions that already have specific standard level requirements[3].

Similar to our proposed approach for revenue recognition, our proposed framework for expense recognition is primarily based on the classification of those expense transactions with performance obligations and those with no performance obligations.

The NZASB's proposed framework for expense recognition is based on two broad approaches:

(a) For all transactions where the resource provider requires the satisfaction of performance obligations[4] by the resource recipient, we proposed applying a PSPOA for expenses (simplified).

    We do not envisage a full 5-step recognition model as proposed under the PSPOA for revenue is required for expense recognition, instead we propose a simplified approach based on the

[3] For example, IPSAS 13 *Leases*, and IPSAS 39 *Employee Benefits*

[4] Transactions involving an outflow of resources from the resource provider and impose on the resource recipient one or more obligations to transfer goods or services, either to the resource provider or to beneficiaries. As discussed in our proposed framework for revenue recognition, these obligations need to be enforceable and sufficient specific to represent performance obligations.

recognition of expenses when the resource recipient has transferred the specified goods or services to the resource provider or agreed beneficiaries.

(b) For other expense transactions, in general, we propose the IPSASB develop an expense recognition approach based on the Conceptual Framework's definition of a liability and the principles and guidance within IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* to determine when the obligating event arises in different circumstances. Hence fourth, we refer to this approach as the "Obligating Event Approach" (OEA).

In general, expenses under this approach will be recognised when the obligating event arises (i.e. when the definition of a liability is met). In certain circumstances, the timing of expense recognition will be impacted by whether an obligation is settled in advance or in arrears of the obligating event. Expenses may be recognised earlier when prepaid (when the resource provider no longer has control over the resources transferred).

Key differences in proposed framework for non-exchange expense recognition

The CP has proposed an Extended Obligating Event Approach (EOEA) for all non-exchange expense transactions (excluding social benefits) with no performance obligations or stipulations, and a PSPOA for all other transactions with performance obligations or stipulations.

In contrast, the NZASB's framework proposes an obligating event approach (OEA) – without any "extension" (as explained further below) – for all expense transactions (excluding social benefits) with no performance obligations, and a PSPOA for all other expense transactions involving an outflow of resources in situations where there are performance obligations imposed on the resource recipient.

NZASB's proposed Obligating Event Approach

The OEA is proposed by the NZASB as an alternative to the EOEA provided for under PV5 of the CP. The OEA is an approach for expense recognition based on the Conceptual Framework's definition of a liability (and associated guidance), and further guidance in IPSAS 19 for obligations of uncertain timing or amount at the reporting date.

Under the Obligating Event Approach, a liability and corresponding expense is recognised when the obligating event arises. The key determinant for liability and expense recognition is whether there is an obligating event – that is 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.

The EOEA proposed by the CP also includes the concept of a liability in the Conceptual Framework and includes consideration of when the obligating event arises. However, the key determinant for liability and expense recognition under this approach is based on whether the resource provider retains control of the resources transferred. This approach is based on IPSAS 23 in reserve, with the recognition of an asset (rather than an expense) based on whether the resource recipient is required to satisfy any stipulations in the form of restrictions over use or conditions requiring the return the resources.

The NZASB does not support the use of an EOEA because it:

(a) uses a model developed for revenue rather than expenses;

(b) requires the retention of the exchange/non-exchange distinction (consistent with our proposed revenue recognition approach, we propose moving away from this distinction for expenses);

(c) requires judgement to determine if a stipulation is a condition or a restriction, which may lead to the recognition of an asset rather than an expense when resources are transferred to a resource recipient; and

(d) is not based on a robust rationale for why the existence of conditions not yet fulfilled leads to the conclusion that an asset exists from the perspective of the resource provider when resources have been transferred to the resource recipient.

The alternative OEA proposed by the NZASB does not focus on whether the resource recipient has unfulfilled restrictions or conditions, because typically the fulfilment of these restrictions or conditions will be outside the control of the resource provider. For example, if the resource provider has already transferred the funding to the resource recipient, the existence of an unsatisfied condition does not mean that the resource provider has an asset equal to the amount of funds transferred. We therefore disagree with the IPSASB's conclusion and rationale in paragraphs 6.20 and 6.21 that the resource provider has control over the resources already transferred. The enforceable right to require the return of those resources, if and when a condition is breached, may give rise to an asset but not for the same amount as the resources transferred. For example, if the possibility of a breach is small, any asset recognised will be for a small amount only.

The NZASB consider that an OEA developed from the context of the resource provider is a better starting point for developing an approach for liability and expense recognition. The OEA would not attempt to mirror a revenue recognition approach, but instead is an approach developed from the context of the reporting entity, the resource provider.

NZASB's proposed framework for recognition of expense transactions in the public sector

Diagram 2 below provides an overview of the NZASB's proposed framework for the recognition of expense transactions in the public sector. Further details of our proposed framework are provided after diagram 2.

Note for Working Group and Board
The diagram below has been provided for internal Working Group and NZASB discussion purposes only to explain our proposed approach and will be formatted further in the final comment letter.

Diagram 2 NZASB's proposed framework for expenses

<table>
<tr><td rowspan="2">Social benefits per ED63</td><td rowspan="2">General obligations to provide services to the public</td><td colspan="4">Grants, contributions and transfers</td><td>Contracts for purchase of G&S</td></tr>
<tr><td>Transfer to individuals/households</td><td>Grant to another entity with no PO or stipulations</td><td>Grant to another entity where there are no PO but there are stipulations</td><td>Grant to another entity where there are performance obligations</td><td>Outflow of resources in exchange for G&S</td></tr>
<tr><td>e.g. state pension</td><td>Universally accessible and collective services e.g. education</td><td>e.g. natural disaster relief</td><td>e.g. general operating grant</td><td>e.g. operating grant with time restrictions, grant for salaries</td><td>e.g. grant to deliver specific no. of vaccinations to beneficiaries</td><td>e.g. purchase of specific no. of vaccinations from supplier</td></tr>
<tr><td colspan="2" rowspan="3">Start analysis with obligating event approach, i.e. definition of a liability in CF and guidance in IPSAS 19 (e.g. based on current legislation and constructive obligations). Timing of obligating event depends on facts and circumstances.
But also need to consider other issues as discussed in social benefits project, e.g.:
- Implications for usefulness of F/S if large liabilities recognised
- Can't recognise right to tax
- Executory/social contract idea
NZASB to consider further when responding to ED63.
No substantive difference in concept between social benefits in ED 63 and many collective/universally accessible services (e.g. national super vs primary & secondary education – in both cases, recipient entitlements are established in current legislation), so consistent approach needed</td><td colspan="2">Obligating event approach with no particular presentation needed (subject to usual IPSAS 1 requirements on disclosing material items)</td><td>Obligating event approach, potentially with enhanced presentation or OCI</td><td colspan="2" rowspan="3">PSPOA for expenses (simplified)
Follow usual accounting for purchases of goods/services from suppliers:
- Where neither party has performed, executory contract so no asset/liability (subject to usual onerous contract requirements)
- If payment made in advance of counterparty performance, then prepayment asset (subject to usual impairment requirements)
- If payment made in arrears of counterparty performance, then liability arises
- Expense arises as and when G & S transferred to beneficiaries, e.g.:
○ if counterparty (supplier or grant recipient) is required to transfer G & S directly to beneficiaries, then expense arises as and when counterparty performs by transferring G & S to beneficiaries
○ When counterparty is required to transfer G & S back to reporting entity, then expense arises as and when the reporting entity transfers G & S to the resource provider</td></tr>
<tr><td colspan="3">Obligating event approach is based on definition of a liability in CF and guidance in IPSAS 19 (e.g. based on current legislation and constructive obligations). Liability arises when the entity is obliged to transfer resources, which will require consideration of the facts and circumstances in each case.
Expense arises when entity no longer has control over resources (see below for elaboration).</td></tr>
<tr><td colspan="2">If payment made after obligating event occurs, then expense arises when obligating event occurs (i.e. liability incurred).
If payment made before an obligating event has occurred (e.g. discretionary grant as per example in IPSAS 19.IG18.2 that was approved and paid without notifying the recipient in advance of payment), then expense arises when paid.</td><td>If paid in arrears, timing (& extent) of expense/liability depends on when (& extent to which) entity no longer has discretion over future transfer.
If paid in advance of stipulations being met, there could be an asset for some portion of the amount paid but depends on whether (& extent to which) the return of funds is likely (based on likelihood of counterparty failing to meet stipulations) and enforceable. Balance of payment is expense.</td></tr>
</table>

Further explanation of the NZASB's proposed framework for expense recognition

<u>Social Benefits, collective services and universally accessible services</u>

We note that the scope of the CP specifically excludes the accounting for social benefit expense transactions. The IPSASB currently has a separate project considering the accounting for social benefits with Exposure Draft (ED) 63 *Social Benefits* currently open for comment.

The accounting for social benefit expense transactions as proposed by ED 63 have been included in Diagram 2 for completeness. The NZASB has yet to commence deliberations on the proposals in ED 63 and we are currently considering our response to the ED proposals.

For this comment letter, the NZASB consider that the determination of an obligating event for social benefit schemes is not substantively different than for public sector schemes for the delivery of collective services and universally accessible services.

For these general obligations to provide services to the public, similar issues arise as are being considered in the IPSASB project on social benefits. In many cases, the beneficiaries of these services have existing rights that have been established through legislation, policy announcements, or other government actions. For example, in New Zealand, the Government's obligations to provide universal superannuation to beneficiaries over 65 (a social benefit) and to provide free education for children aged between 5 and 19 (a universally accessible services), are both established through legislation. In our view, there is no substantive difference between benefits provided in the form of money (e.g. national superannuation) or in the form of services (e.g. education services). Accordingly, issues being discussed in the project on social benefits relating to determining the point when (and the extent to which) the government concerned has a present obligation to provide those benefits also arise in the context of universally accessible and collective services.

Therefore, the NZASB considers that where expense transactions such as social benefits, collective services, and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. We therefore encourage the IPSASB consider how any decisions made in the development of standard-level requirements for social benefits will impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as collective and universally accessible services.

Furthermore, in our view, the IPSASB conclusion in paragraph 6.38 that there is no obligation prior to the delivery of services is highly questionable, and the rationale provided appears to mix the issue of measurement of a liability with the existence of a liability – the fact that a government might be able to vary the level of services provided could impact on *the extent* of its obligation to beneficiaries, but it does not follow that *no* obligation exists.

Nevertheless, we appreciate that an alternative conclusion that a liability arises at an earlier point has potentially significant consequences. It raises issues similar to those discussed under the social benefits projects – for example:

(a) the usefulness of the financial statements if large liabilities are recognised for obligations to deliver future ongoing services to the public;

(b) public sector entities are often obligated to provide services to the public in future periods, based on the expectation that the funding will be obtained from the public substantially in future periods (and entity cannot recognise an asset for the right to collect future taxes); and

(c) accounting for executory contracts – some argue that the government's right to collect future taxes from which it will meet its obligations to provide social benefits, and other services that are part of the ongoing activities of the government, are akin to an executory contract with its citizens.

<u>Other ad-hoc obligations to provide resources to the public</u>

We note the CP has mainly focuses on the accounting for universally accessible services and collective services when discussing liability and expense recognition arising from obligations to provide resources to the public.

Public sector entities will have a wide range of other obligations to the public that relate to specific government programmes, such as the provision of relief to affected individuals or households in the event of a natural disaster. In certain circumstances, an obligation could exist before the reporting entity has transferred resources to the beneficiaries concerned or engaged with a supplier or another entity to deliver the services, so will represent a present obligation at the reporting date. For example, in implementing a programme of services of the public, there are various points in time to consider when a present obligation may arise:

(a) public expectations established from past practices of the public sector entity, creating a constructive obligation;

(b) making a political promise such as an electoral promise;

(c) announcements of a policy;

(d) passing of legislation (if applicable) to implement the policy;

(e) approval or the budget or communication of budget appropriations; or

(f) when the budget becomes effective.

The early stages of implementing public policy are unlikely to give rise to present obligations that meets the definition of a liability, because there is greater ability to avoid the outflow of resources. Later stages, especially when any eligibility criteria or stipulations are met, are more likely to give rise to present obligations that meet the definition of a liability, because there is less ability to avoid the outflow of resources.

In our view, the definition of a liability in the Conceptual Framework and the guidance in IPSAS 19 can be applied in determining when a liability (and corresponding expense) arises for other ad-hoc obligations to provide resources to the public.

We note the CP does not fully address the accounting for these other non-exchange expense transactions that arise for other ad-hoc obligations to provide resources to the public. We encourage the IPSASB to complete further analysis for this category of non-exchange expenses.

Grants, contributions and transfers to another entity – with no performance obligations or stipulations over use

When an obligation requires an outflow of resources from a resource provider, for which the resource recipient is not required to satisfy any performance obligations or stipulations, the liability and expense will be recognised immediately when the obligating event occurs. In these circumstances, the reporting entity has little or no realistic alternative to avoid an outflow of resources, when the transfer is approved and communicated to the resource recipient.

When settlement of an obligation occurs in advance or in arrears of the obligating event, then the Conceptual Framework's definition of a liability and asset should be considered to determine when the expense should be recognised.

Settlement after an obligating event has occurred

If settlement occurs after an obligating event has occurred, then the liability and expense is recognised when obligating event occurs (i.e. when the definition of a liability is satisfied). In these circumstances, the settlement of the obligation will result in a reduction of the liability already recognised.

Settlement before an obligating event has occurred

If settlement occurs at a time when an obligating event has not yet occurred, then the expense transaction is recognised at the point of settlement. In these circumstances, the resource provider no longer has control of the resources transferred when settled, because there are no performance obligations or stipulations and therefore the resource provider does not an enforceable right to require the resource recipient to return the resources (i.e. the prepayment does not satisfy the definition of an asset).

This outcome may arise when a grants, obligation or transfer is approved by the resource provider and paid without notifying the resource recipient in advance of the payment. For example, suppose a potential grant recipient applies for a discretionary grant, which the resource provider later approves and makes payment at the same time as notifying the recipient that the grant has been approved. In these circumstances, the payment of the obligation and the obligating event will occur simultaneously.

Grants, obligations and transfers – with no performance obligations but with stipulations over use

When an obligation requires outflow of resources from the resource provider, for which the resource recipient is not required to satisfy any performance obligations, but there are stipulations over use, the liability and expense will be recognised immediately when the obligating event occurs.

A PSPOA for these non-exchange expenses as proposed by the CP, is not considered appropriate because the resource recipient is not required to satisfy any performance obligations.

For these transactions with no performance obligations but there are stipulations over use, in the form of restrictions, conditions or other enforceable stipulations, we are proposing the OEA be applied, together with the either the presentation option or the OCI option to highlight any stipulations over use.

We consider there are two potential options to enhance the presentation of expenses recognised in the surplus or deficit of the resource provider in the reporting period, which have stipulations over use which are expected to be satisfied by the resource recipient in future periods. We have explained these two options below. Later, we provide our views on which option is our preferred option.

1. Presentation and disclosure— expenses are recognised when the obligating event occurs but with enhanced presentation through the statement of financial performance and note disclosure to highlight any stipulations over use not satisfied by the resource recipient at the reporting date. This option is similar to the presentation option that we discuss in the context of revenue recognition.

2. Other comprehensive income — presenting revenue and expenses outside of the reported surplus or deficit, similar to the presentation of other comprehensive income (OCI) in IFRS Standards. This option is similar to the OCI option that we discussed in the context of revenue recognition. It would be appropriate only for transactions where there are resources transferred with clear stipulations imposed by the resource provider. This is because the stipulations need to be sufficiently clear to enable the resource provider to determine when the stipulation has been met or has lapsed.

   On initial recognition, the resource provider would recognise the expense as a debit in OCI within the statement of financial performance and then it is taken to a separate reserve within net assets/equity. As the resources are consumed by the resource recipient, the OCI is recycled from the separate reserve to expenses.

   This option keeps the balance sheet consistent with the definition of elements in the Conceptual Framework. An expense will still be recognised in the statement of financial performance when incurred but through a separate section called OCI or an equivalent.

   This option would only work if the IPSASB develops principles for what can be recognised in OCI and recycled to surplus or deficit. This option would not work if the expenses are recognised directly in net assets/equity and there is no recycling. If the resources are recognised directly in net assets/equity with no recycling, this is less transparent and potentially misleading, as it does not clearly reflect the outflow of resources.

   The IPSASB will need to consider how far to take this OCI approach for expense transactions with different forms of stipulations including time requirements. If this approach is advanced further, we would suggest it only be permitted when the resource provider has the ability or mechanisms in place to monitor the resource recipient's progress towards satisfying the agreed stipulations.

These two options to highlight the stipulations over use are consistent with those we have proposed for revenue transactions with no performance obligations, but have stipulations over use.

Overall, the NZASB has similar views on which approach to apply as discussed earlier in the context of revenue recognition, in that the majority of NZASB members prefer the presentation option, with a minority preferring the OCI option. In addition, some NZASB members that prefer the presentation option might also accept the OCI option if there are significant difficulties in developing the presentation option. However, some NZASB members consider that there are different considerations in the context of expense recognition compared with revenue recognition and, therefore, do not necessarily consider that the same approach should apply to the resource provider.

Question for the Board
Should our comment letter propose the consideration of an OCI approach for non-exchange expenses with no performance obligations, but with stipulations over use?

Settlement in arrears of stipulations being met

If settlement occurs in arrears of the stipulations being met, then the liability and expense recognition will depend of when (and to what extent) the entity no longer has the discretion to avoid the future outflow of resources. A present obligation only exists to the extent in which an entity has little or no realistic alternative to avoid an outflow of resources.

In some cases, the existence of unfulfilled stipulations at the reporting date may provide the resource provider with the discretion to avoid incurring the future outflow of resources. This will depend on the terms of the arrangement and whether the resource recipient has already commenced activities to fulfil those stipulations. For example, for future funding relating to activities that have not yet commenced, it is necessary to consider whether (and the extent to which) the arrangement gives the resource provider the discretion to terminate or modify the arrangement, and thereby avoid future payments. In these circumstances, a liability and expense would not be recognised because a present obligation arising from past events does not exist. Judgement is required is determine in what circumstances the resource provider can legitimately withdraw from or modify the arrangement.

For example, if an operating grant is provided with future funding instalments based on time requirements only, then the resource provider can only legitimately withdraw from future instalment payments when there is evidence that the resource recipient will not continue operating in the future. Without this evidence, it is unlikely the resource provider has the control to avoid a future outflow of resources at the reporting date, and a liability and expense for the full amount of agreed future grant payments should be recognised. Claims that are unconditionally enforceable subject to the passage of time are generally considered to be present obligations in the context of the definition of a liability.

We encourage the IPSASB to develop guidance at a standards-level on the circumstances in which a stipulation remains within the control of the resource provider, resulting in the resource provider having a realistic ability to avoid a future outflow of resources. This could entail drawing and building upon the existing guidance on IPSAS 19.

Settlement in advance of the stipulation being met

If payment is made in advance of the resource recipient having satisfied the stipulation, then typically the expense should be recognised when paid (if not already recognised earlier). In some cases, an asset might arise.

For example, it could be appropriate to recognise an asset in the following circumstances:

(a) clear repayment provisions for non-compliance with any stipulations have been agreed with the resource recipient;

(b) there is a history of the resource provider seeking refunds for non-compliance with any stipulations; and

(c) it is considered probable that there will be an inflow of resources from the resource recipient resulting from non-compliance with any stipulations.

The above will include consideration of whether the resource recipient has the resources available to return the funds, in the event of failing to meet an agreed stipulation (and the time value of money, if significant).

Grants are often paid in advance to provide other public sector and non-for-profit entities with the funding required to continue operations. We therefore expect it would be unusual for the resource provider to expect stipulations will not be satisfied, when an arrangement is initially entered into. However, in subsequent reporting periods, evidence may become available that the stipulations will not be satisfied. At this time, the resource provider will reconsider if an asset for the return of resources should be recognised.

<u>Grants, obligations and transfers – arrangement for the transfer of goods or services to beneficiaries (specific and enforceable)</u>

The NZASB is of the view that where an arrangement entails specific and enforceable performance obligations for the resource recipient to transfer goods or services either to beneficiaries or to the resource provider themselves, the resource should account for the outflow of resources by using the PSPOA for expenses.

Under this approach, the obligating event arises for the resource provider when agreed performance obligations are satisfied by the resource recipient.

Consistent with our proposed approach for revenue, the PSPOA for expenses should only apply to transactions with performance obligations, and therefore we do not agree with PV7 that the PSPOA for expenses should also apply the non-exchange transactions with stipulations.

Settlement in advance of performance obligations being satisfied

If payment is made in advance of the resource recipient having satisfied the performance obligation, then a prepayment asset is recognised. When there are specific and enforceable performance obligations it is assumed that remedies are available for the return of funds when agreed goods or services are not delivered.

Settlement in arrears of performance obligations being satisfied

If payment is made after the resource recipient has satisfied the agreed performance obligations, then a liability and expense is recognised at the point in which the agreed goods or services have been transferred to either the resource provider or the agreed beneficiaries.

APPENDIX 2 Response to Preliminary Views and Specific Matters for Comment

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 reason.

Draft response

We broadly agree with PV1, subject to our earlier comments on our proposed framework and our comments below.

As discussed earlier, under our proposed framework, the existence or absence of performance obligations in revenue transactions should be the key determinant for revenue recognition in the public sector.

Therefore, in our view, all revenue transactions with performance obligations should be accounted for under an IPSAS based on IFRS 15, the PSPOA. Hence, we consider that the PSPOA should be applied more broadly than Category C transactions. As noted in our discussion of our proposed framework, there is scope for certain transactions in Category B to be accounted under the PSPOA. This includes performance obligation transactions that are enforceable through other means and involves the transfer of goods or services to beneficiaries, including those which are subsidised or on a cost-recovery basis.

However, the scope of the PSPOA will depend on how the IPSASB defines key factors such as enforceability and performance obligations.

An IPSAS based on IFRS 15 will assist our PBE groups that include for-profit controlled entities by reducing unnecessary consolidation adjustments for Category C revenue transactions.

An IFRS 15 convergence project for Category C revenue transactions may appear simple at face value. However, this process will likely include a number of challenges as recently experienced by the AASB which completed a similar project at the end of 2016. Some of the challenges the AASB had to address are noted below. Some of these challenges are already covered in the *Broadened for the Public Sector* sections of the CP chapter 4, but we wanted to re-emphasise their importance for when the IPSASB develops an IPSAS based on IFRS 15.

- Enforceability – what is enforceability in the public sector? The AASB noted a return obligation is an indicator of enforceability, but not the only indicator. The AASB expanded the enforceability guidance to include a range of factors that could potentially result in an enforceable arrangement. Some examples of these factors are the resource provider's right to enforce specific performance or claim damages or agreement on the alternative uses for the resources provided. The IPSASB will need to consider the appropriate enforcement mechanisms in the public sector which results in the resource recipient having a present obligation for unfulfilled performance obligations.

- Performance obligations – what is a performance obligation in the public sector? AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* notes some resources are provided with no, or minimal, terms and conditions on how the resources must be used. Other resources may have stipulations only in the form of time requirements. For these reasons, it can be difficult to distinguish goods or services provided to meet a general requirement from any of the not-for-profits' other goods or services provided[5]. The AASB kept the principle that a performance obligation exists only if it is sufficiently specific to enable the recipient to determine when it has satisfied that obligation[6]. In addition, as discussed earlier, the type of "performance obligations" within the scope of the PSPOA should be limited to those that require the transfer of goods or services to other parties, rather than the broader notion of "performance obligation" currently in IPSAS 23.

  The IPSASB will need to develop an appropriate definition of a performance obligation with supporting guidance. The definition should be consistent with the definition of a performance obligation in IFRS 15, but adapted for the public sector.

- Transactions with two components – how to account for transactions where there is a performance obligation and another component? For example, in a fundraising dinner, the ticket price could exceed the usual market rate for the dinner, indicating that there are two components: the dinner (for which there is a performance obligation) and a donation. The AASB developed guidance on determining the circumstances in which the donation component should be separated from the performance obligation component.

- Licences – the AASB is currently considering the accounting treatment of public sector licences. Issues it is considering include determining the circumstances in which the revenue from granting a licence is, in substance, a tax (and hence should be accounted for in the same way as taxes) or involves the delivery of goods or services (and hence should be accounted for under the PSPOA). For some public sector entities, accounting for licence revenue is a significant issue, so the IPSASB will need to consider how this will be addressed.

- Direct relationships between inputs and outputs – in the public sector, there are transactions where the arrangement does not explicitly require the transfer of a good or service but may do so implicitly where there is a direct relationship between the funding and the outputs delivered. Such arrangements have all the criteria to fall within the scope of IFRS 15 except the explicit requirement to transfer goods or services. We think these transactions could be accounted for under the PSPOA because, in substance, they are substantially similar to an IFRS 15 transaction – the resource provider is effectively funding the delivery of the outputs

5 AASB 2016-8.BC38

6 AASB 2016-8.BC49

(goods or services) to other parties. For example, the resource recipient receives funding for the salary for one of its employees and the resource provider directs the output of that employee for the benefit of the resource provider. In this situation, there is a direct relationship between the funding and the output (from the employee).

- Output-based appropriations – In New Zealand, certain public sector entities receive funding via output-based appropriations where the resource provider specifies what outputs the recipient must deliver with the funding . This can be viewed as either (a) funding the recipient or (b) buying outputs from the recipient. The recipient is accountable to the resource provider for the delivery of the agreed outputs and the arrangement is monitored by the resource provider. We recommend the IPSASB carry out research on the specificity of funding arrangements within the public sector of different jurisdictions and consider which of these transactions could appropriately be accounted for using the PSPOA.

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.

Draft response

As discussed earlier, our proposed framework for revenue transactions in the public sector would distinguish between revenue transactions with performance obligations and those without performance obligations.

Therefore, we agree revenue transactions in Category A should be accounted for under a residual standard or a residual section of a standard, based on the applicable parts of IPSAS 23. IPSAS 23 would, of course, need to be updated to address practice issues relating to Category A transactions, as discussed further below in our response to SMC 1.

However, it is important to note that under our proposed framework, some parts of IPSAS 23 will be no longer applicable, such as those parts dealing with:

- the distinction between exchange and non-exchange transactions; and
- the distinction between restrictions and conditions.

Also, a future revenue standard (or section of a standard) for Category A transactions, and those transactions in Category B that do not contain performance obligations and hence are not accounted for under the PSPOA, will need to have a clearly worded scope section to make it clear that it applies only to these types of revenue transactions. For example, the standard should not apply to other transactions, such as public sector combinations.

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.

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.

Notes for Specific Matter for Comment 1

At the October Board meeting, a Board member commented that the Board should consider whether the discussion of contributions from owners in IPSAS 23 conflicts with the definitions in the IPSASB *Conceptual Framework* and the possible conflicts. We have included relevant extracts from IPSAS 1 *Presentation of Financial Statements* (which defines contributions from owners), IPSAS 23 (which discusses contributions from owners), and the IPSASB Conceptual Framework (which defines ownership contributions) for the Board's information.

IPSAS 23 was developed before the Conceptual Framework. The IPSASB may want to modify or remove paragraphs 37–38 of IPSAS 23 now that it has the Conceptual Framework. The IPSASB intends to review the IPSASs against the chapters on elements and recognition from the Conceptual Framework; this is a proposed project for the *Strategy and Work Plan 2019–2023*. We have drafted a suggested comment on this matter (see draft response below).

IPSAS 23

Contributions from Owners

37. Contributions from owners are defined in PBE IPSAS 1. For a transaction to qualify as a contribution from owners, it will be necessary to satisfy the characteristics identified in that definition. In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered. Paragraph 38 indicates the form that contributions from owners may take. If, despite the form of the transaction, the substance is clearly that of a loan or another kind of liability, or revenue, the entity recognises it as such and makes an appropriate disclosure in the notes to the general purpose financial statements, if material. For example, if a transaction purports to be a contribution from owners, but specifies that the reporting entity will pay fixed distributions to the transferor, with a return of the transferor's investment at a specified future time, the transaction is more characteristic of a loan. For contractual arrangements, an entity also considers the guidance in PBE IPSAS 28 *Financial Instruments: Presentation* when distinguishing liabilities from contributions from owners.

38. A contribution from owners may be evidenced by, for example:

(a) A formal designation of the transfer (or a class of such transfers) by the contributor or a controlling entity of the contributor as forming part of the recipient's contributed net assets/equity, either before the contribution occurs or at the time of the contribution;

(b) A formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets/equity of the recipient that can be sold, transferred, or redeemed; or

(c) The issuance, in relation to the contribution, of equity instruments that can be sold, transferred, or redeemed.

IPSAS 1

Definitions

Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

(a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or

(b) Can be sold, exchanged, transferred, or redeemed.

Conceptual Framework

5.33 Ownership contributions are:

Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

5.37 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured. Ownership distributions may be: (a) a return on investment; (b) a full or partial return of investment; or (c) in the event of the entity being wound up or restructured, a return of any residual resources.

Draft response

We have identified the following matters for the IPSASB to consider in developing a residual standard (or section of a standard) based on updating the applicable content from IPSAS 23.

- Consider modifying the taxable event to a taxable period. For example, property rates are set before the beginning of the year (this is the taxable event under IPSAS 23) but the rates relate to services provided to ratepayers throughout the year rather than the point at which the rates are levied.

- There is no guidance on appropriations in IPSAS 23. Is appropriation a revenue or a contribution from owners? If the appropriation is from central government to a government department, this is a fund from the “owner” so is it a contribution from owners?

- As noted in our comments on Preliminary View 1, the IPSASB will need to consider developing guidance for the recognition of revenue from granting licences. Is it a delivery of goods or services or is it a tax?

- Also, there are other types of specific rates or taxes that are related to particular goods or services, such as water rates. The IPSASB should consider developing guidance to help determine which revenue standard (or section of the standard, if there is only one revenue standard) applies to these transactions.

- In the proposed *Strategy and Work Plan 2019–2023,* one of the IPSASB's proposed projects is to review IPSASs against the chapters on elements and recognition from the Conceptual Framework. As part of this review, the IPSASB should consider modifying or removing paragraphs 37–38 of IPSAS 23 which provides guidance on contributions from owners. IPSAS 23 was developed before the Conceptual Framework and this guidance may no longer be needed now that the IPSASB has the Conceptual Framework.

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.

Draft response

We agree that some Category B transactions should be accounted for using the PSPOA.

However, as noted in our earlier comments on our proposed framework, there is a wide spectrum of transactions in Category B. The scope of Category B transactions that could be accounted for using the PSPOA will depend on how the IPSASB defines key factors such as enforceability and performance obligations.

Under our proposed framework, all revenue transactions with performance obligations should be accounted for under the PSPOA. The PSPOA would be appropriate for revenue transactions that involve the transfer of goods or services to either the resource provider or resource beneficiaries. The PSPOA won't be appropriate for consumption-based stipulations (even if they are accompanied by return conditions or other enforcement mechanisms) because these are not performance obligations.

We have identified transactions which are currently in IPSAS 23 that can be accounted for using the PSPOA. As discussed earlier, these are transactions that are enforceable through other means and involve the transfer of goods or services to beneficiaries, including those which are subsidised or on a cost-recovery basis. See our earlier discussion of our proposed framework for the full details.

We have also identified a range of issues to be considered in developing the PSPOA, as discussed in PV1.

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.

Draft response

We agree with broadening the requirements of the IFRS 15 model in developing the PSPOA. We have commented on steps 1 and 2.

Step 1 – *Identify the binding arrangement*

- We agree with the broader concept of enforceability. In discussions with constituents, some have advocated a further broadening, but we do not agree that it would be appropriate, for example, to extend this to moral obligations. A PSPOA is appropriate only when the resource provider has enforcement mechanisms available, as discussed earlier (e.g. see our response to PV 1).
- The IFRS 15 revenue recognition approach should be extended under the PSPOA to capture revenue transactions with three party arrangements (resource provider, resource recipient and resource beneficiary). The key requirement is for the resource recipient to have an obligation to transfer goods or services to an external party, which could be the resource provider or the third-party resource beneficiary. This approach is consistent with IFRS 15, as the customer may not always receive the goods or services in transactions that fall within the scope of IFRS 15 (e.g. where a customer contracts with a florist to deliver flowers to a third party).
- One of the criterion for a contract to fall within the scope of IFRS 15 is commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract). The AASB's 2016-8 noted that contracts that include a subsidy or which are provided on a cost-recovery basis can be accounted for under IFRS 15. Although these arrangements provide goods or services without generating a commercial return, they may still cause a change in the risk, timing or amount of the not-for-profit entity's future cash

flows[7]. Therefore transactions that transfer goods or services to beneficiaries with a subsidy or cost-recovery basis can be accounted for under the PSPOA.

Step 2 – *Identify the performance obligations*

- The IPSASB will need to develop an appropriate definition of a performance obligation with supporting guidance. The definition should be consistent with a performance obligation as defined in IFRS 15 but adapted for the public sector.

- In the public sector, identifying specific performance obligations and unbundling performance obligations will require a greater level of judgement than in the for-profit sector because there is often less detail on the specification of the goods or services to be delivered. We therefore encourage the IPSASB to develop guidance on defining specific performance obligations in a public sector context.

- To assist preparers in identifying specific performance obligations within binding arrangements in the public sector, we suggest the following factors[8] be considered:

  (a) the nature or type of the goods or services;

  (b) the cost of value of the goods or services;

  (c) the quantity of the goods or services; and

  (d) the period over which the goods or services must be transferred.

  In general, for a performance obligation to be considered specific enough for the PSPOA to be applied, these factors will need to be identified as agreed terms which are enforceable.

- We agree with the IPSASB's view in the CP that a time requirement in and of itself does not create a performance obligation. For revenue transactions where the time period for using the resources is specified, but the exact nature of the goods or services to be transferred is not specified, these transactions should be accounted for under a residual standard (or residual section of a standard). For the PSPOA to apply, there has to be a link between the resources received and transfer of goods or services externally.

- Also, see our earlier responses for other issues to consider (e.g. our response to PV1).

[7] AASB 2016-8.F19

[8] AASB 2016-8.F20

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.

Draft response

As noted earlier, our preference is for the IPSASB to develop an approach based on whether or not there are performance obligations arising from Category B transactions, rather than developing requirements based on the current exchange or non-exchange classification. We accept that for revenue transactions with no performance obligations, but there are stipulations over use (relating to either when or how the funds must be used), a residual standard (or residual section of a standard) is required for these transactions (together with Category A transactions).

We don't support Approach 1 as it:

- does not resolve the current issues experienced with the exchange or non-exchange distinction in IPSASs;
- does not promote the accounting for a broader range of public sector transactions under an IFRS 15 revenue recognition approach; and
- addresses concerns regarding the accounting for transactions with time requirements only. It does not address the accounting for other public sector transactions which may not have performance obligations as defined under IFRS 15 but which have other stipulations as to how the funds must be used.

Whilst we don't support Approach 1, we support the IPSASB in considering option (b) and an extension of option (e) for transactions with no performance obligations but which have stipulations over use. We explain these two options below.

Presentation

Under our proposed framework, this option is the same as Approach 1 "The Exchange/Non-Exchange – Update IPSAS 23", option (b) proposed in the CP. Revenue is recognised when resources are received or receivable but with enhanced presentation to highlight the stipulations over use. This option stays true to the definitions of elements in the Conceptual Framework and gives the entity a method of communicating its performance story to the users of financial statements. This option would help to educate users to focus not only on the surplus or deficit (the "bottom line") but to look at what makes-up the surplus or deficit.

A university in New Zealand, the University of Auckland (Auckland University), has used this presentation option (under the current PBE Standards that are based on IPSAS) to separate its unrestricted and restricted funds in the statement of financial performance, statement of financial position and statement of changes in net assets. These statements are supported by accounting policies and notes disclosure. Auckland University wanted to clearly identify its core operating activities and thought this presentation was the best way to achieve this. This example may be of interest to the IPSASB in developing this option[9].

Financial Accounting Standards Board (FASB) Statement No. 117, *Financial Statements of Not-for-Profit Organisations* (Statement No. 117) provides specific guidance for the presentation of restricted funding received by not-for-profits (NFPs) within general purpose financial statements. Statement No. 117 requires classification of an organisation's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. It requires that the amounts for each of three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities[10]. Statement No. 117 provides guidance using the columnar presentation.

In 2016 the FASB issued Accounting Standards Update 2016–14 *Presentation of Financial Statements of Not-for-Profit Entities* (ASU)[11]. The main changes in ASU are:

- the three classes of net assets in the statement of financial position and the change in each of those classes of net assets in the statement of activities are replaced with two classes, net assets with donor restrictions and net assets without donor restrictions;
- enhanced disclosures about the composition of net assets with donor restrictions at the end of the period and how those restrictions affect the use of resources; and
- requiring an analysis of how the nature of the NFP's expenses relates to its programmes and supporting activities.

The FASB's guidance maybe of interest to the IPSASB in developing this option.

In developing this option, we recommend the IPSASB does not mandate this requirement as it would create extra compliance costs for preparers, particularly for those entities that are not significantly impacted by stipulations over use. However, the IPSASB could encourage this option in the statement of financial performance in the period the resources are received so users can understand the entity's results and the impact of the stipulations on the resources received. To assist preparers

9 University of Auckland 2016 Annual Report https://cdn.auckland.ac.nz/assets/auckland/about-us/the-university/official-publications/annual-report/2016-annual-report-university-of-auckland.pdf

10 Equivalent to a statement of financial performance

11 https://asc.fasb.org/imageRoot/56/92564756.pdf

in applying this option, we recommend that the IPSASB develop illustrative examples so that preparers can see what these presentations could look like.

Other comprehensive income

Under our proposed framework this option is an extension of Approach 1, option (e) proposed in the CP. Our option would require the IPSASB to develop principles for presenting revenue and expenses outside of surplus or deficit, similar to the presentation of OCI in IFRS Standards (for the reasons explained below). This option would be appropriate only for transactions where there are resources with clear stipulations imposed by the resource provider. On initial recognition, the resources would be recognised in other comprehensive income within the statement of financial performance and then taken to a separate reserve within net assets/equity. As the resources are used over the specified time or as the stipulations are fulfilled (or lapse), other comprehensive income is recycled to revenue. Our suite of PBE Standards already has the concept of OCI, which we refer to as “other comprehensive revenue and expense”. Before introducing our suite of PBE Standards based on IPSAS, our public sector entities had previously applied New Zealand equivalents to IFRS Standards, including OCI, so we carried forward OCI into our suite of PBE Standards.

This option keeps the balance sheet consistent with the definitions of elements in the IPSASB Conceptual Framework. The resources will still be recognised in the statement of financial performance when received or receivable, but through a separate section called OCI or an equivalent.

This option overcomes the strict principle in IPSAS 23, which does not permit resources with no conditions to be recognised over time. This approach acknowledges the stipulations placed on the resources as this is shown clearly in the statement of financial performance and is more likely to result in revenue being included in surplus or deficit in the same periods in which the resources are used.

This option would work only if the IPSASB develops principles for what can be recognised in OCI and all OCI is subsequently recycled to surplus or deficit. This option would not work if the resources are recognised directly in net assets/equity and there is no recycling. If the resources are recognised directly in net assets/equity with no recycling, this is less transparent and potentially misleading, as it is presenting a message that the recipient is no better off in terms of financial performance, which does not reflect the substance of the transaction.

The IPSASB will need to consider how far to take this OCI approach for transactions where the stipulation is not for a limited period of time, such as permanently restricted assets such as land. Under this option, these resources could permanently be in OCI because of the permanent restriction.

Option (c) and option (d)

For completeness, we would like to note that we don’t support option (c) because it does not meet the definition of a liability.

We also don’t support option (d) because we don’t support the introduction of the notion of “other obligations”, which are not liabilities. We also note that time requirements are not an economic phenomena that should be treated any differently from other revenue transactions with no performance obligations but which have stipulations over use.

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.

Draft response

As noted earlier, our preference to is to distinguish between revenue transactions with performance obligations and those without performance obligations. This approach could result in fewer scope debates and more meaningful revenue recognition discussions especially for non-accountants, dependent upon how clearly the IPSASB is able to define a performance obligation.

However, if the IPSASB retains the exchange or non-exchange distinction, then we agree additional guidance on this distinction should be used in combination with our preferred options in Specific Matter for Comment 3. Additional guidance on this would be helpful given the issues in application. We agree that additional guidance would be required on the meaning of the phrases “directly giving” and “approximately equal value” which are currently used in the definition of non-exchange transactions.

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.

Draft response

We agree the IPSASB should address the accounting for capital grants in an IPSAS. This is an important matter for our constituents so we encourage the IPSASB to develop appropriate solutions.

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.

Notes for Specific Matter for Comment 5

- Under AASB 1058 *Income for Not-for-Profit Entities*, the recipient of a capital grant accounts for the cash received as a financial asset in accordance with AASB 9 *Financial Instruments*, and the obligation to build the asset is recognised as a liability at the time the agreement is entered into. The related income is recognised as the obligation to construct the asset is fulfilled i.e., over time, and the asset is recognised in accordance with the relevant accounting standard e.g., AASB 116 *Property, Plant and Equipment*. IFRS 15 requires a transfer of goods or services to a customer. Usually a capital grant requires the recipient to acquire or construct the asset and keep control of the asset. The AASB has kept to this principle and dealt with capital grants under AASB 1058 rather than AASB 15. The AASB noted the capital grant accounting mirrors the approach in IFRS 15 to the extent appropriate, so the same accounting would have been achieved had the transaction been accounted for as a contract with a customer under IFRS 15. The AASB noted that in substance, the transferor had intended to transfer a recognisable non-financial asset to the recipient[12].

- At the October meeting, the Board had discussed two proposals for the accounting of capital grants:

  OCI approach

  - A capital grant does not seem any different to other grants with stipulations. The main difference being that the resources are used to construct or acquire a capital asset that is recognised on the balance sheet. The other grants are for operational matters that is recognised in the statement of financial performance when spent.

  - Could the restriction go beyond the construction period and revenue be recognised over the life of the asset? For example, what does this mean for permanently restricted assets such as land that must be used for a specific purpose?

Question for the Board

Under an OCI approach for capital grants, could the restriction go beyond the construction period and revenue is recognised over the life of the asset?

[12] AASB 1058 *Income for Not-for-Profit Entities*, BC98

PSPOA

- o The AASB noted the capital grant accounting mirrors the approach in IFRS 15 to the extent appropriate, so the same accounting would have been achieved had the transaction been accounted for as a contract with a customer under IFRS 15. The AASB noted that in substance, the transferor had intended to transfer a recognisable non-financial asset to the recipient[13].

- Another option could be the presentation option.

Draft response

(a) Yes, the IPSASB has identified the main issues with capital grants.

(b) The IPSASB should consider the following proposals for the accounting of capital grants.

OCI approach

- o Based on discussions for the OCI option in our proposed framework, a capital grant does not seem any different to other grants with stipulations. The main difference being that the resources are used to construct or acquire a capital asset that is recognised on the balance sheet. The other grants are for operational matters that are recognised in the statement of financial performance when spent.
- o The IPSASB will need to consider what this approach will mean for permanently restricted assets that must be used for a specific purpose, such as land.

PSPOA

- o In substance, the transferor intends to transfer a recognisable non-financial asset to the recipient, therefore revenue should be recognised over the period of the construction or acquisition[14].
- o The AASB has used this approach in AASB 1058. The IPSASB could use AASB 1058 as guidance in developing this approach.

Presentation approach

This option is the same as Approach 1 “The Exchange/Non-Exchange – Update IPSAS 23”, option (b) proposed in the CP. This option stays true to the definitions of elements in the Conceptual Framework and gives the entity a method of communicating its performance story to the users of financial statements.

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13 AASB 1058 *Income for Not-for-Profit Entities*, BC98

14 AASB 1058.BC98

Question for the Board

Which approach(es) for the accounting of capital grants should be in the comment letter for the IPSASB consider?

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.

Draft response

The NZASB supports retaining the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind. Leaving this as optional allow entities the choice as to whether they recognise services in-kind; entities will do so if the benefits outweigh the cost.

If the IPSASB mandates the recognition of services in-kind, entities would have to develop systems and processes to gather auditable information (which may be a challenge to audit). Preparers could end up treating this as an accounting compliance exercise. In New Zealand, compliance costs associated with the recognition of services in-kind would be an issue for many public sector entities, and particularly registered charities (which are generally subject to the same requirements as public sector entities).

Whilst we support retaining the existing guidance, we suggest the IPSASB review the disclosure of services-in kind. Currently in IPSAS 23.108, entities are encouraged to disclose the nature and type of major classes of services in-kind received, including those not recognised. The IPSASB could consider mandating this disclosure. This is one way to improve the financial reporting in this area.

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.

Draft response

As discussed earlier, under our proposed framework for expense recognition, we do not agree that non-exchange transactions related to universally accessible services and collective services should be accounted for under an EOEA.

In particular, we do not agree with the "extended" part of the obligating event approach, as we disagree with the conclusion and rationale in paragraphs 6.20 and 6.21 that the resource provider has control over the resources already transferred. The enforceable right to require the return of those resources, if and when a condition is breached, may give rise to an asset but not for the same amount as the resources transferred. For example, if the possibility of a breach is small, any asset recognised will be for a small amount only.

In general, for non-exchange expense transactions with no performance obligations, we have proposed an obligating event approach, based on the Conceptual Framework's definition of a liability, and further guidance in IPSAS 19 where applicable.

However, for universally accessible services and collective services, we consider that similar issues arise as are being considered in the current IPSASB project on social benefits. For this comment letter, the NZASB consider that the determination of an obligating event for social benefit schemes is not substantively different than for public sector schemes for the delivery of collective services and universally accessible services.

The NZASB considers that where expense transactions such as social benefits, collective services, and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. We therefore encourage the IPSASB consider how any decisions made in the development of standard-level requirements for social benefits will impact the development of an approach for collective and universally accessible services.

Further discussion on the NZASB's proposed approach is provided in Appendix 1.

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.

Draft response

We do not agree with the rationale provided for the PV and consider that this issue requires considerable further discussion and analysis before a robust conclusion can be reached.

In our view, the IPSASB conclusion in paragraph 6.38 that there is no obligation prior to the delivery of services is highly questionable, and the rationale provided appears to mix the issue of measurement of a liability with the existence of a liability – the fact that a government might be able to vary the level of services provided could impact on *the extent* of its obligation to beneficiaries, but it does not follow that *no* obligation exists.

In many cases, the beneficiaries of these services have existing rights that have been established through legislation, policy announcements, or other government actions. For example, in New Zealand, children have a right to free education between age 5 and 19 (a universally accessible services) under existing legislation. In accordance with the guidance in the Conceptual Framework, the existence of liabilities is based on existing legislation[15]. Hence, it could be argued that a liability already exists to provide education to existing citizens under the age of 19.

Nevertheless, we appreciate that a conclusion that a liability arises at an earlier point than when the services are delivered has potentially significant consequences. It raises issues similar to those discussed under the IPSASB's social benefits project. We do not consider that there is a substantive difference between the types of expenses being discussed in the social benefits project and universally accessible and collective services. We therefore encourage the IPSASB consider how any decisions made in the development of standard-level requirements for social benefits will impact the development of an approach for universally accessible and collective services.

Further discussion on this matter is provided in Appendix 1.

Other comments

The public sector has a wide range of general obligations to provide services to the public, which include universally accessible services and collective services as defined by the CP. When developing standard-level requirements, it will be important to clarify that any guidance on the accounting for non-exchange expense transaction arising from universally accessible services and collective services is in the context of determining when obligations to provide those services to beneficiaries arise before the reporting entity engages with another organisation, employee or supplier to deliver the services to the public.

The CP notes that the delivery of universally accessible services and collective services may involve a number of exchange transactions. We expect that expense transactions arising from universally accessible services and collective services, when the reporting entity engages with a supplier to deliver the services to the public, will have performance obligations and should therefore be accounted for as under the PSPOA. Therefore, it will be important to make it clear when different expense recognition approaches will apply to the various stages of implementing a programme of delivering services to the public.

[15] Paragraph 5.22 of the IPSASB's *Conceptual Framework*

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.

Draft response

The NZASB does not agree that a PSPOA should be applied to all non-exchange expense transactions that contain either performance obligations or stipulations.

Consistent with our proposed framework for revenue recognition, we consider that a PSPOA is only appropriate for expenses transactions with performance obligations – that is, transactions where the resource recipient has an enforceable and specific obligation to transfer goods or services to the resource provider or agreed beneficiaries.

Under the proposed PSPOA for expenses, we consider that a simplified approach could be developed, based on recognising a liability and expense when performance obligations are satisfied by the resource recipient, rather than developing a full PSPOA based on the IFRS 15 five-step recognition model modified reflect the resource provider context.

The simplified PSPOA for expenses will require the following to be considered.

(a) Definition of a performance obligation such as specificity of the goods or services to be delivered.

(b) Definition of enforceable, what enforcement mechanisms in addition to a return obligation would allow for a PSPOA to be applied?

(c) Accounting for payments in advance of the delivery of goods or services – similar to payments made in advance to suppliers in an exchange transaction, a prepayment asset would arise.

Where the PSPOA for expenses is applied to transactions involving the resource recipient transferring specific goods and services to beneficiaries, we consider this approach will only be appropriate where the resource recipient provides reliable reporting on progression of service performance delivery to the resource provider.

Further discussion on the NZASB's proposed approach is provided in Appendix 1.

General comments on chapter 7 Measurement

- The purpose of the chapter was to discuss the measurement of non-contractual receivables and non-contractual payables. As the CP has focused on statutory receivables and statutory payables we think this is probably what the CP intended to discuss.

- Paragraph 4.31 of the CP notes that many public sector arrangements are non-contractual and many binding arrangements are established through means other than legal contracts. Paragraph 7.5 of the CP notes that donations and bequests are other examples of non-contractual receivables. Therefore only a small portion of public sector receivables and payables are contractual. The scope of chapter 7 is wider than what the actual chapter has covered.

- Given the wide scope of non-contractual receivables and non-contractual payables, we recommend that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. This will then drive the appropriate measurement.

- There is no question on the initial measurement of non-contractual payables. The chapter has PVs for the initial and subsequent measurement of non-contractual receivables. We don't know whether SMC7 was meant to include initial measurement as well.

- The feedback we have obtained has been on statutory receivables and statutory payables.

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.

Notes for Preliminary View 8

- The CP has focused only on statutory receivables and provided a preliminary view only on the initial measurement of statutory receivables. The intended scope of the CP is non-contractual receivables so it covers all receivables that are non-contractual. The type of revenue should dictate the appropriate measurement.

  For example, under our proposed framework, if the transactions have performance obligations they will be accounted for using the PSPOA, the initial measurement of receivables should be an IPSAS based on IFRS 15. Subsequently, any impairment on receivables are recognised in accordance with an IPSAS based on IFRS 9.

  Under our proposed framework, statutory receivables generally do not have performance obligations or stipulations. For these types of transactions it would be appropriate to initially measure at face value. This measurement promotes accountability and transparency. At the November Board meeting, it was noted that face value has information value and this can be supported with disclosing the fair value.

- The South African Accounting Standards Board's (ASB) Standard of Generally Recognised Accounting Practice 108 *Statutory Receivables* (GRAP 108) requires statutory receivables to be initially measured in accordance with the relevant standard of GRAP. For example if the transaction is an exchange transaction, the standard of GRAP to apply is *Revenue from Exchange Transactions*. The subsequent measurement is the cost method with adjustments for accrued interest, impairment and amounts derecognised.

  Impairment is required to be assessed at every reporting date. Given the volume of receivables, the ASB agreed that this assessment should be made firstly for any individually significant statutory receivables and, then by grouping together groups of individually insignificant statutory receivables which exhibit similar characteristics. The ASB concluded that the impairment approach adopted should be similar to the value-in-use approach in the Standard of GRAP on *Impairment of Non-Cash-generating Assets*[16].

- AASB 2016-8 requires statutory receivables to be accounting for by applying the initial measurement requirements under AASB 9. The AASB is of the view that these receivables are similar in economic substance to financial assets under AASB 9 and therefore should be initially measured at fair value. Entities have the choice on the subsequent measurement.

- PV 8 is consistent with the New Zealand government's accounting policy for sovereign revenue prior to the adoption of the PBE standards.

- The Crown's current accounting policy is that receivables arising from sovereign revenue are initially recognised at the amount of sovereign revenue levied to be owing. Where the amount expected to be received is less than the amount owing, an impairment is also recognised. If a broad view of PBE IPSAS 23 is taken, then this initial measurement is acceptable, as it represents the value at which the Crown is willing to accept the receivable (per the IPSAS rather than the IFRS Standards definition of fair value), which is then written down to the amount expected to be received.

  An alternative view of PBE IPSAS 23 is that it requires the recognition of receivables and revenue at fair value. If the amount expected to be received is less (i.e. fair value) than the face value, the fair value is the net of the uncollectible amount.

  The Crown's accounting policy has been accepted the auditors on the grounds of materiality and cost/benefit.

- Face value for statutory receivables is more understandable to users and the balance sheet asset is appropriately measured.

Draft response

Our general comment on this chapter is that the discussion in the chapter is narrower than we expected. The chapter states that its purpose is to discuss the measurement of non-contractual receivables and non-contractual payables. However, the chapter focuses on statutory receivables and statutory payables only. We have assumed that the focus on statutory receivables and payables was intentional.

Paragraph 4.31 of the CP notes that many public sector arrangements are non-contractual and many binding arrangements are established through means other than legal contracts. Paragraph 7.5 of the CP notes that donations and bequests are other examples of non-contractual receivables. Therefore, only a small portion of public sector receivables and payables are contractual. The scope of chapter 7 of the CP is wider than what the actual chapter has covered.

[16] GRAP 108.BC31

Given the wide scope of non-contractual receivables and non-contractual payables, we recommend that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. This will then drive the appropriate measurement. The South African Accounting Standards Board's (ASB) GRAP 108 *Statutory Receivables* may assist the IPSASB with the measurement of statutory receivables. We have provided further details of GRAP 108 below.

Therefore, we don't agree with the preliminary view that all non-contractual receivables should be measured at face value on initial recognition.

GRAP 108 has guidance on the initial and subsequent measurement of statutory receivables. GRAP 108 requires statutory receivables to be initially measured in accordance with the relevant standard of GRAP. We suggest the IPSASB look at GRAP 108 for guidance in developing the initial measurement of non-contractual receivables.

Examples of where initial measurement would be different under our proposed framework follow.

- Transactions with performance obligations will be accounted for using the PSPOA. The initial measurement of receivables should be an IPSAS based on IFRS 15. Subsequently, any impairment on receivables are recognised in accordance with an IPSAS based on IFRS 9.

- Statutory receivables generally do not have performance obligations or stipulations. For these types of transactions (which would be in the residual revenue standard (or residual section of a standard) based on an updated version of the applicable parts of IPSAS 23), it would be appropriate to initially measure the receivable at face value. Face value has information value and it easier for users to understand. This measurement promotes accountability and transparency. The face value can be supported with disclosure of the fair value.

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.

Notes for Preliminary View 9

- A Treasury representative agrees with the fair value approach for the subsequent measurement.

- Under GRAP 108, the subsequent measurement for statutory receivables is the cost method. The ASB chose the cost method over the amortised cost method because constituents noted the complexity with the latter method. Most statutory receivables are non-exchange in nature, a considerable amount of reliance is place on the use of estimates, both to identify when a transaction can be recognised as well as the amount at which it should be measured. Where estimates are used to measure receivables under the amortised cost, whenever the estimates are revised the receivable would need to be revised to reflect not only the change in estimate, but also the discounting of those revised estimates. This means that any revisions to the estimates would give rise to a profit or loss as the new estimates would need to be discounted using the effective interest rate[17].

Draft response

The NZASB agrees with Preliminary View 9 for statutory receivables. However, as noted in our response to Preliminary View 8, the CP has focused only on statutory receivables. The scope of chapter 7 of the CP is *non-contractual receivables*, this covers all receivables that are non-contractual. Subsequent measurement of non-contractual receivables will depend on the type of revenue.

Given the wide variety of non-contractual receivables, we recommend that the IPSASB first establish the recognition approaches for revenue. This will then help to drive the appropriate measurement.

For statutory receivables, the fair value approach has appeal because it appears the most workable of the three approaches to apply in practice. However, we would strongly support the IPSASB determining the presentation and disclosure for statutory receivables starting from scratch, and not automatically adopting all the disclosures from IFRS 9 by analogy. Many of the IFRS 9 disclosures have been designed with commercial contractual arrangements in mind, with a focus on counter-party credit risk. Many of the disclosures therefore won't be applicable to statutory receivables.

In the New Zealand context, the government's tax receivable portfolio is not overly sensitive to discount rates, but that may not be the case in other jurisdictions. The IPSASB will need to consider how the volatility in a discounted cash flow is best presented in the statement of financial performance. Also, the IPSASB would need to consider where the fair value gain or loss is displayed in the statement of financial performance and what it is called. It may be better to display the movement in the same line each year, regardless of whether it moved from a loss or gain in different years.

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.

Notes for Specific Matter for Comment 7

- The current New Zealand Government accounting policy for taxes payable is nominal value. This is a reasonable approximation of the fair value. This measurement is most aligned with

17 GRAP 108.BC19

the cost of fulfilment approach and IPSAS 19 requirements. A Treasury representative supports the cost of fulfilment approach.

- At the November NZASB meeting, the Board noted:
  - The subsequent measurement of non-contractual payables can apply the current requirements in IPSAS 19. Paragraph 7.45 of the CP notes that some jurisdictions are using IPSAS 19.
  - The cost of fulfilment approach is similar to the IPSAS 19 requirements.
- The cost of fulfilment approach is consistent with the proposals in ED 63 *Social Benefits.* As noted in paragraph 7.36 of the CP, social benefits are also non-contractual payables and don't have the characteristics of insurance contracts.
- In 2012 the ASB issued Discussion Paper 7 *Assets and Liabilities Arising from Non-Contractual Arrangements that have the Features of Financial Instruments* (the DP). The DP proposed using an amortised cost model for non-contractual receivables and non-contractual payables (where the timing and amount of the non-contractual payables was certain). The DP proposed the requirements under GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets*[18] when the timing and amount of the non-contractual payable was uncertain. The ASB thought there was merit in considering symmetry – this was important if the same economic entity had both the receivables and payables. Respondents to the DP rejected the amortised cost approach for non-contractual receivables and supported the cost approach. The ASB concluded that non-contractual payables should continue to be accounted for using GRAP 19.

Draft response

As noted in our response to preliminary views 7 and 8, given the wide range of non-contractual receivables and non-contractual payables, we recommend that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. This will then drive the appropriate measurement.

Until the IPSASB does further work on the measurement of non-contractual payables, at this stage the NZASB supports the application of the IPSAS 19 requirements for the subsequent measurement of non-contractual payables. IPSAS 19 requires provisions to be measured using the best estimate of the expenditure required to settle the present obligation at the reporting date. This is an appropriate measurement for non-contractual payables, and, as noted in the CP, is the approach currently used by some jurisdictions.

[18] GRAP 19 is the equivalent to IPSAS 19.

Consultation Paper
August 2017
Comments due: January 15, 2018

Accounting for Revenue and Non-Exchange Expenses

International Public Sector Accounting Standards Board®

196608.1

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

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.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

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 Views[1] 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

CONTENTS

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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;
- Resources[2] 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 services[3] 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).

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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*).

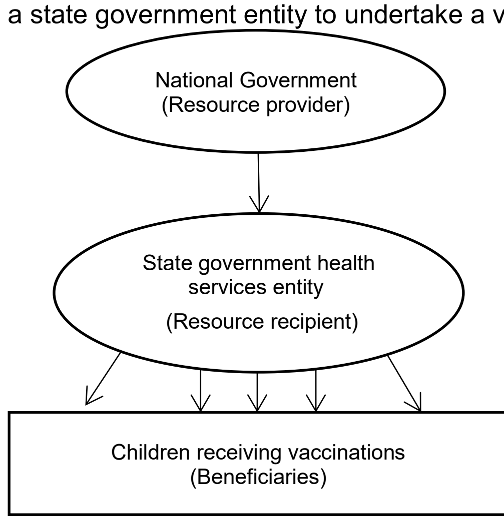
1.5 The CP addresses accounting for both revenue and non-exchange expense transactions. Various approaches are described and evaluated. An exchange/non-exchange approach based on updating IPSAS 23 and a Public Sector Performance Obligation Approach (PSPOA) (drawn from IFRS 15) are discussed as potential 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 liabilities[5], 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.

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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 requirements[7] 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 interpretations[8]. 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.

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[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 presentation[9] 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.

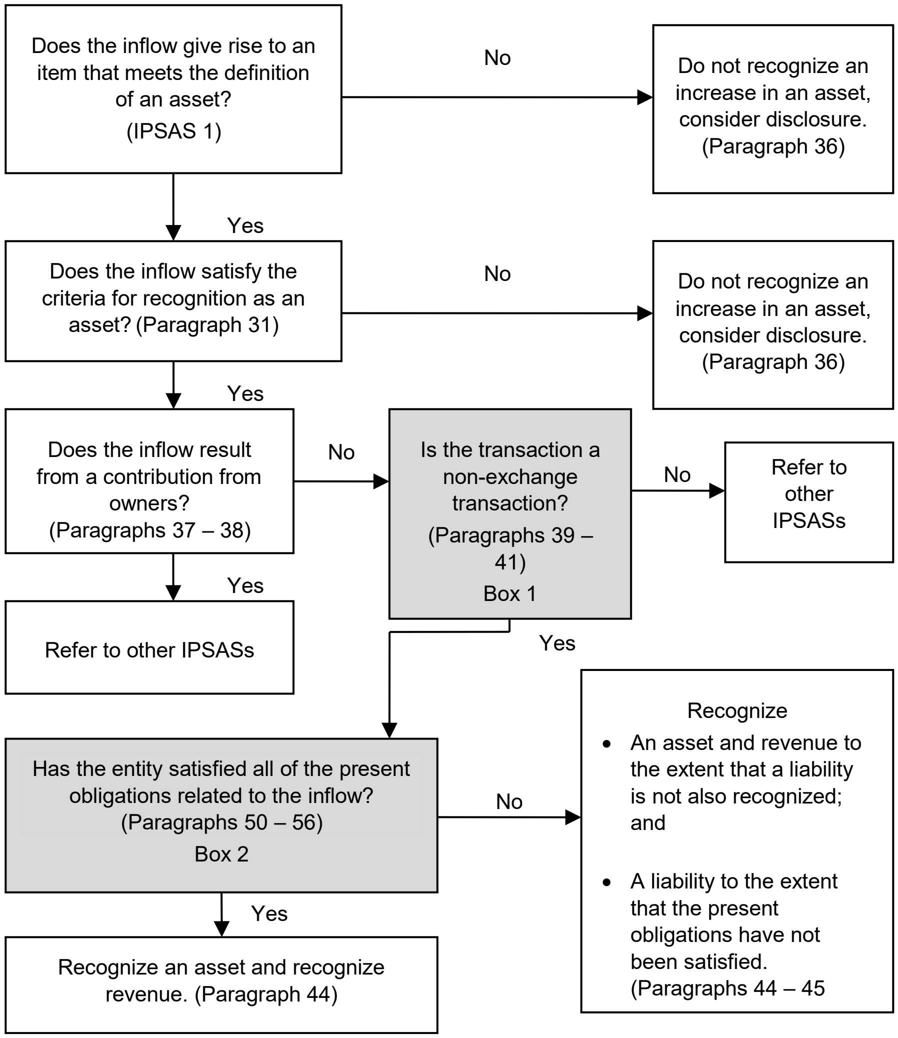
Non-Exchange Transactions

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 tax[10], noting that it is essential for preparers to analyze the taxation law in their jurisdictions to determine the taxable event.

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

IPSAS 23 acknowledges the following examples of transfers – grants, debt forgiveness, fines, bequests, gifts, donations and goods and services[11] in-kind – and provides commentary on each.

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 contact 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.

[11] From here on in, 'goods and services' in the public sector are just called 'services'

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.

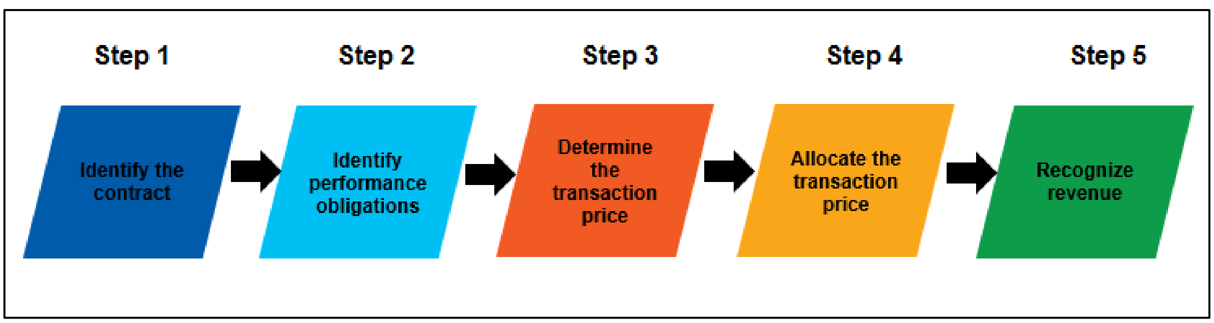
2.21 The core principles of the IFRS 15 performance obligation approach are:

(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 *distinc*t 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

(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 contributions[12], 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-exchange[14] 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 means[15] 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 periods[16]; 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

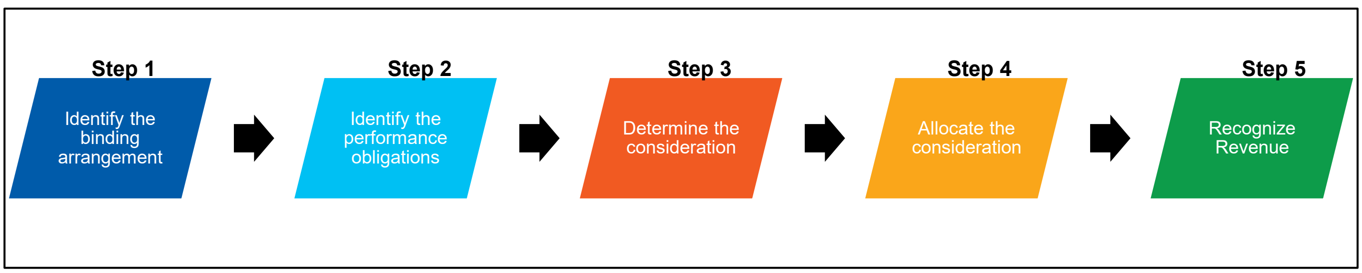
(d) More variation and uncertainty about enforceability. This is because many agreements will not be legal contracts. Consequently there may be less detail in the agreement on enforcement mechanisms.

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 customer[21] 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: 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	Public Sector Performance Obligation Approach for Revenue
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: 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	Public Sector Performance Obligation Approach
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-kind[22]. 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 asset[23.] 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;

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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 IPSAS[24]). 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 transfers[25].

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.

	Non-Exchange Expenses Project				Social Benefits	Other IPSAS / IFRS		
Category	**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	Yes	No	No
Adresses needs of society as a whole?	Sometimes	Yes	Yes		Yes	No	No	No
Excludes universally accessible services?	Sometimes	Yes	No	No	Yes	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 attributes[26]:

(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.

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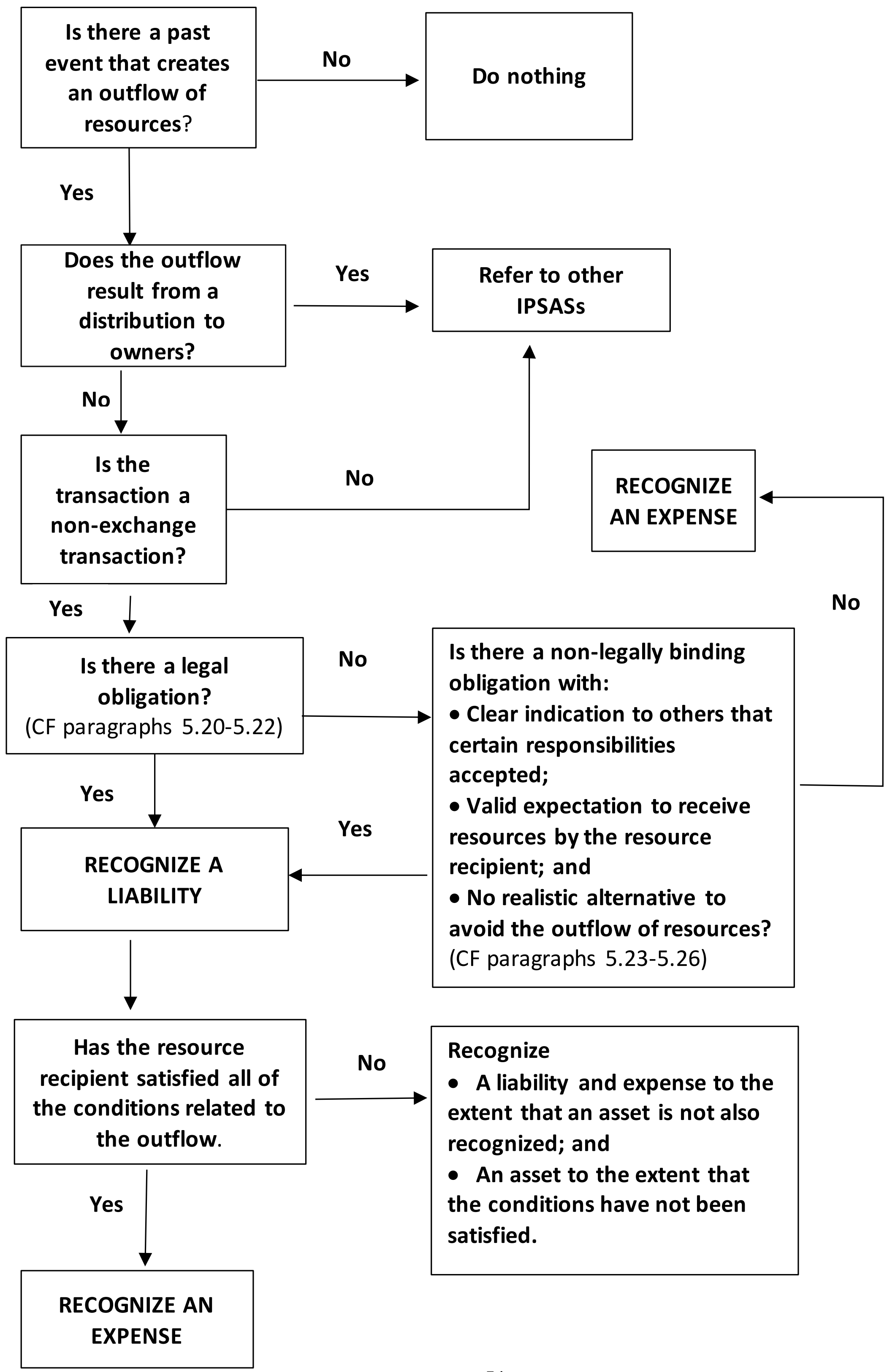
[26] Paragraph 5.23 of The IPSASB Conceptual Framework

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.

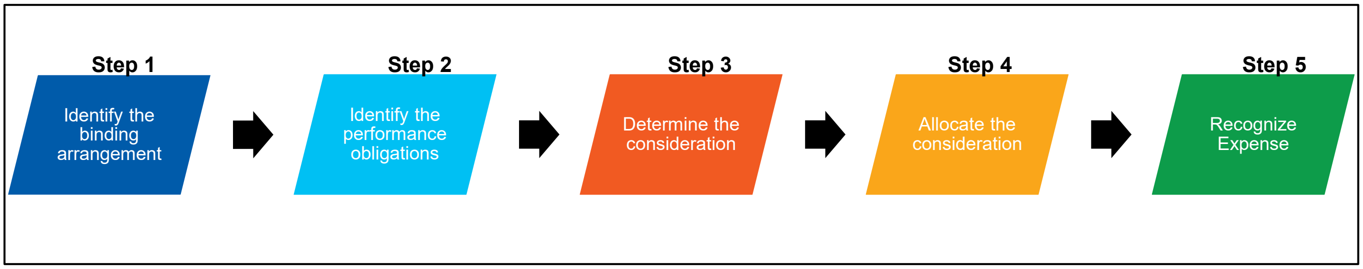
THE EXTENDED OBLIGATING EVENT APPROACH



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

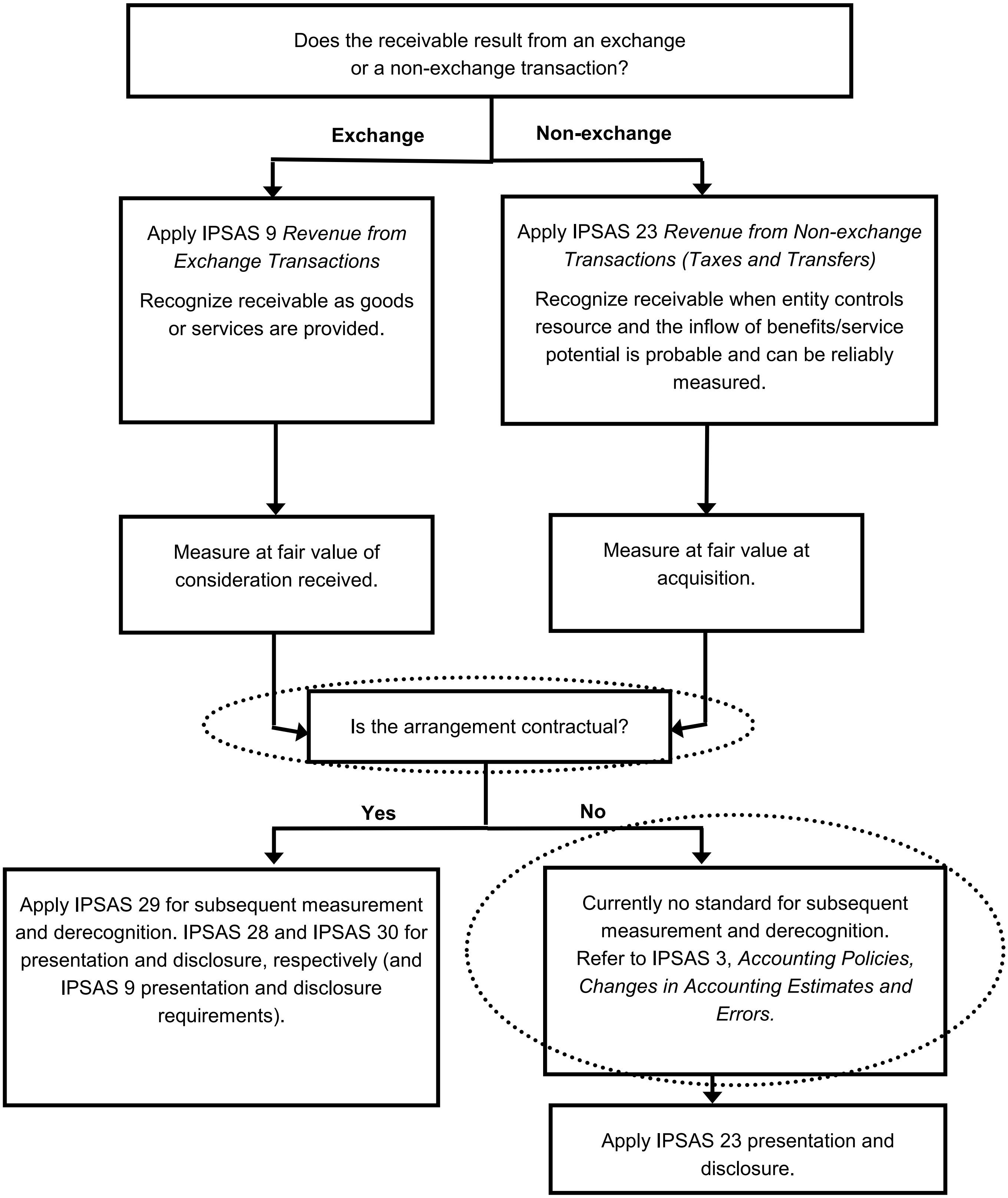
(e) Licenses.

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 value[27] 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

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[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 CP[31], 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.

Appendix A

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 *Conceptual Framework*	**Yes** IPSAS 23 is consistent with the elements in Chapter 5 of the IPSASB *Conceptual Framework.* 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			
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 *Conceptual Framework*	**Yes** IPSAS 23 is consistent with the elements in Chapter 5 of the IPSASB *Conceptual Framework* – changing the presentation would not alter this.		Any display/disclosure proposals would need to be consistent with the presentation chapter in the Conceptual Framework.
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**
Recognize revenue over more than one reporting period (if applicable) **(see paragraph 4.7)**	**Yes** Because resources received with no other stipulation other than when the resources are intended to be used would be classified as a 'condition'. Revenue would be recognized in the time period the resource provider intended them to be used rather than when receivable.		

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*	**Yes** The IPSASB *Conceptual Framework* 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.		
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		**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 (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**
Recognize revenue over more than one reporting period (if applicable) **(see paragraph 4.7)**	**Yes** Because resources received with no other stipulation other than when the resources are intended to be used would be classified as ‘other obligations’. Revenue would be recognized in the time period the resource provider intended them to be used rather than when receivable.		

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 *Conceptual Framework*	**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 Conceptual *Framework*.		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**
Recognize revenue over more than one reporting period (if applicable) **(see paragraph 4.7)**	**Yes** 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.		

Approach 2 – Public Sector Performance Obligation Approach (PSPOA)			
Issue	**Advantage**	**Disadvantage**	**Comment**
Consistent with the IPSASB *Conceptual Framework*	**Yes** The proposals re revenue and liability recognition are consistent with the concepts in the IPSASB *Conceptual Framework*.		
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.

Appendix B

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:

Option1(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.

Step 2 – Identify the performance obligations — the administering of each vaccination to a member of the public is considered a distinct service under the agreement, therefore each vaccination is a performance obligation.

Step 3 – Determine the consideration — the total agreed consideration of CU5 million is promised for the administration of 1 million vaccinations to the public.

Step 4 – Allocate the consideration — consideration of CU5 million is allocated to each performance obligation as it is fulfilled - that is CU5 is allocated to each vaccination as it is administered.

Step 5 – Recognize revenue — as each vaccination is administered, the health services entity recognizes CU5 as revenue (decreasing a liability that was initially recognized when the consideration was receivable (on signing of the agreement)).

These are the journal entries that would apply:

DR Cash	CU5 Million
CR Liability	CU5 Million

A liability is recognized by the health service entity when the agreement is signed and the consideration is receivable, the funding is receivable in advance of any performance obligations being fulfilled by the health services entity.

DR Liability	CUXX
CR Revenue	CUXX

Revenue is recognized as the vaccinations are administered to the public. The amount of the consideration is in direct relation to the number of the vaccinations administered – CU5 per vaccination by the number of vaccinations administered per month – until delivery of the vaccination program is completed.

Conclusion

The current IPSAS 23 and the PSPOA produce different revenue recognition outcomes.

Under current IPSAS 23 requirements, revenue is recognized by the government health services entity for the total CU5 million when the consideration is receivable. 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.

In contrast, under the PSPOA, because there are enforceable performance obligations imposed on the health service entity to administer the vaccinations to the public, revenue is recognized as the vaccinations are administered, at CU5 per vaccination.

Recognition of expense by the national government

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

The Extended Obligating Event Approach

The funding agreement between the national government and government health services forms a binding 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 al 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 firs 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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