



Staff Paper

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Income from Non-Exchange Transactions – Measurement of Performance Obligations and Other Non-Financial Liabilities

Introduction

1. This paper discusses the measurement of performance obligations and other non-financial liabilities, particularly in the context of the Boards exploring how the IASB's proposed revenue recognition model might be applied to income from non-exchange transactions. In AASB Agenda Paper 10.6 /FRSB Agenda Paper B7.6, AASB staff recommend departing from the measurement proposals in the IASB ED on Revenue from Contracts with Customers in order to deal appropriately with transactions with non-exchange components. In that sense, AASB Agenda Paper 10.6 /FRSB Agenda Paper B7.6 potentially trumps the considerations in this paper. Nevertheless, if the staff's recommendation is not supported, it would be necessary to consider the application issues relating to the IASB's measurement proposals, which are discussed in this paper.
2. The proposed measurement attributes for performance obligations in AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* and the IASB ED on Revenue from Contracts with Customers are set out in Table 1. ED 180/ED 118 proposed the same measurement attributes for performance obligations and other non-financial liabilities.

Table 1: Proposed Measurement Requirements for Performance Obligations

ED 180/ED 118	IASB ED on Revenue from Contracts with Customers
“... the best estimate of the amount required to settle the present obligation at the reporting date” (paragraph 58)	the allocated transaction price ¹ (paragraph 34)
<u>Guidance:</u> “The estimate for [these] liabilities takes account of the risks and uncertainties that surround the events causing the liability to be recognised. Where the time value of money is material, the liability will be measured at the present value of the amount expected to be required to settle the obligation. This requirement is in accordance with the principles established in AASB 137 / NZ IAS 37.” (paragraph 59)	<u>Guidance:</u> “An entity shall allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (ie on a relative stand-alone selling price basis).” (paragraph 50)

Comments by Respondents to AASB ED 180/FRSB ED 118

3. Of the nine respondents to ED 180/ED 118 who commented on the proposal in ED 180/ED 118 that performance obligations and other non-financial liabilities² should be measured on the same basis as provisions (i.e., as per AASB 137/NZ IAS 37), five³ agreed, two⁴ disagreed and two⁵ did not express an overall view but expressed some concerns.
4. The respondents who disagreed did so because of the difference between the measurement bases for financial and non-financial liabilities, and between the measurement bases for

¹ The ‘transaction price [for a contract with a customer]’ is defined as “The amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes)” (Appendix A).

² Paragraph 58 of the ED referred to these liabilities as ‘liabilities other than advance receipts and financial liabilities’. Different terminology is used in this staff paper to relate the discussion to the IASB’s measurement proposals for performance obligations in its ED on Revenue from Contracts with Customers.

³ Joint Accounting Bodies, KPMG (Aust), PwC (Aust), South Aust. Treasury and PwC (NZ)

⁴ HoTARAC and Finance Department

⁵ UHY Haines Norton and Ernst & Young

non-financial assets and non-financial liabilities.⁶ AASB and NZICA staff observe that these differences are not specific to the proposals in ED 180/ED 118. Rather, they exist in IFRSs and IPSASs generally. Therefore, staff suggests this project is not the place to address those differences.

5. One respondent not expressing an overall view on the issue⁷ commented that the distinction between performance obligations and financial liabilities needs to be clarified. Under the proposals in the IASB ED on Revenue from Contracts with Customers, performance obligations and return obligations would each be recognised as liabilities. Applying those proposals should largely overcome the respondent's concern.

Brief Critique of the Proposed Requirements in ED 180/ED 118 and in the IASB ED on Revenue

6. Measuring performance obligations within the scope of this project on the same basis as provisions, as proposed in ED 180/ED 118, would have the advantage of limiting the range of measurement attributes used for liabilities. Performance obligations meet the definition of 'provisions', even though they would be outside the scope of AASB 137/NZ IAS 37. A 'provision' is defined in AASB 137/NZ IAS 37 as "a liability of uncertain timing or amount" (paragraph 10).
7. Unlike the allocated transaction price, the "best estimate of the amount required to settle the present obligation" (fulfilment value) is a measure of the expected outflow of economic benefits from settling the liability, and therefore represents the burden currently imposed on the entity by the obligation. In addition, measuring performance obligations at the best estimate of the amount required to settle the present obligation provides useful information for assessing the entity's future cash outflows.

⁶ The respondents also criticised the different measurement bases for financial liabilities and advance receipts liabilities, but that difference is not relevant to the measurement of non-financial liabilities. Therefore, it is not discussed here.

⁷ Ernst & Young

8. A concern with measuring performance obligations on the same basis as provisions is that ‘day one’ gains can arise.⁸ In addition, any measurement error would affect income immediately. These concerns were expressed by the IASB in its ED on Revenue from Contracts with Customers, and the AASB and FRSB generally agreed with the IASB in their submissions on that ED. The importance of the concern about ‘day one’ gains may be reduced in transactions that are non-exchange or have a non-exchange component (i.e., the consideration exceeds the fair value of the obligation incurred). This is because some ‘day one’ income would appropriately be recognised by the recipient of the transferred assets.
9. Having noted briefly some relative merits of the measurement attributes proposed for performance obligations in ED 180/ED 118 and the IASB ED on Revenue from Contracts with Customers, paragraphs 10 – 22 focus on PBE/NFP-specific issues that may affect the application of the IASB’s proposed measurement attribute (including whether any PBE/NFP-specific issues indicate applying the IASB’s proposed measurement attribute would be impracticable or inappropriate). This is because the AASB and FRSB tentatively agreed in October 2010 that, to identify performance obligations, the Boards should continue working on an approach that applies the IASB’s proposed guidance but modifies that guidance to the extent necessary to address specific PBE/NFP issues. Logically, the same approach should be applied to the measurement of performance obligations and other liabilities arising from transactions giving rise to income of PBEs/NFPs.

PBE/NFP-Specific Issues Arising from Application of the Measurement Proposals for Performance Obligations in the IASB ED on Revenue from Contracts from Customers

10. Applying the measurement proposals for performance obligations in the IASB ED on Revenue from Contracts with Customers involves allocating the transaction price to all separate performance obligations using a relative stand-alone selling price basis.

⁸ ‘Day one’ losses can also arise, but this is not unique to measuring performance obligations on the same basis as provisions. Under the IASB ED on Revenue from Contracts with Customers, losses arise if performance obligations are identified as onerous.

11. It might be argued that measuring performance obligations of PBEs/NFPs using stand-alone selling prices would be unworkable for many transactions⁹ on the basis that:
- (a) arguably, PBEs/NFPs do not ‘sell’ goods or services they are obligated to provide as a result of receiving transferred assets; and
 - (b) even if PBEs/NFPs are regarded as ‘selling’ goods or services they are obligated to provide, there are PBE/NFP-specific difficulties with applying the proposed requirement. These difficulties are described in paragraph 13.
12. In relation to the factor in paragraph 11(a), those who see no substantive distinction between ‘exchange’ and ‘non-exchange’ transactions consider that the provision of specified goods or services in return for consideration is a sale in substance, even if not termed as such. Therefore, they disagree that being a PBE or NFP would, of itself, be an impediment to applying the proposed requirement. AASB staff agree with that conclusion.
13. Possible PBE/NFP-specific difficulties with applying the proposed requirement to allocate the transaction price to all separate performance obligations using a relative stand-alone selling price basis are:
- (a) there is often not a one-to-one relationship between each transfer of assets to a PBE/NFP and the amount of goods or services the entity is obliged to provide as a result. (For example, donations may be provided by a large number of individual donors and then provided to third parties in accordance with the donors’ stipulations.¹⁰ Another example is a public sector PBE/NFP that receives an appropriation to be used for the provision of a wide range of different goods or services by that entity.) Consequently, for some performance obligations:
 - (i) the ‘transaction price’ is the sum of the amounts of transfers from a number of different parties; and/or

⁹ If the scope of the revised ED is income of PBEs/NFPs, it would encompass income from commercial transactions a PBE or NFP may enter to supplement its income from other sources. The concern discussed in this sentence would not apply to commercial transactions (everyday sales) made by PBEs/NFPs.

¹⁰ However, in many cases, the promises made by donees may lack the degree of specificity and/or enforceability necessary for a liability to exist.

- (ii) the ‘transaction price’ applies to a much larger unit of account (bundle of goods or services) than each performance obligation the PBE/NFP is measuring; and
 - (b) where a PBE/NFP provides a service tailored to the needs of particular beneficiaries, the services to which a performance obligation relates may be too dissimilar from other services for ‘prices’ of comparable services to be observed.
- 14. In relation to the factor in paragraph 13(a)(i), AASB staff note that the AASB and FRSB tentatively agreed in October 2010 that it is unnecessary to specify which entity should be regarded as the ‘customer’, because the focus should be on the nature and extent of the PBE’s/NFP’s performance obligations. Staff think an implication of that decision is that there should be no impediment to having multiple ‘customers’ (i.e., parties to whom an obligation is owed) in respect of a particular unit of account for a ‘performance obligation’ (or group of ‘performance obligations’). Therefore, staff do not consider that identifying a ‘transaction price’ as the sum of the amounts of transfers from a number of different parties would make measuring performance obligations of PBEs/NFPs using stand-alone selling prices unworkable.
- 15. In relation to paragraph 13(a)(ii), staff observe that receiving transfers of assets in relation to a wide range of stipulated goods or services is not unique to PBEs/NFPs. Many for-profit entities sell goods or services in a package deal that includes bespoke components (e.g., customer-specific software development) the stand-alone selling price of which must be estimated.
- 16. In relation to paragraph 13(a)(ii) and paragraph 13(b), staff think it will depend on the circumstances whether the stand-alone selling price of a good or service that is the subject of a PBE’s/NFP’s performance obligation can be observed or estimated reliably. For some goods or services (including those provided in large quantities), the per-unit price for similar goods or services will be observable from transaction prices. However, in some instances (e.g., where a PBE/NFP provides a service tailored to the needs of particular beneficiaries), there might not exist observable prices for similar goods or services. A more prevalent problem for PBEs/NFPs is that the transaction price has no necessary

connection with the performance obligations arising from the transaction, and therefore provides fewer signals to help the entity allocate amounts to individual performance obligations.

17. In relation to paragraph 16, having agreed prices with the transferor to which a current performance obligation relates would not be sufficient evidence of a stand-alone selling price. The IASB ED on Revenue from Contracts with Customers says “A contractually stated price or a list price for a good or service shall not be presumed to represent the stand-alone selling price of that good or service” (paragraph 51). Arguably, when a PBE/NFP has a single customer (e.g., a government or a government department) for particular goods or services it provides, a stand-alone selling price for an item customarily provided as part of a bundle of different goods or services could not be directly observed. This is because there are no transactions with other parties to support the reliability of prices agreed with the single customer.
18. Nevertheless, the IASB ED does not rely on stand-alone prices being directly observed. It proposes that entities estimate stand-alone prices that are not directly observable. It notes that suitable estimation methods include an ‘expected cost plus a margin approach’ and an ‘adjusted market assessment approach’ (see Appendix A for details), although these are not the only permissible methods.

‘Expected cost plus a margin approach’

19. Staff expect that an ‘expected cost plus a margin approach’ might be more readily applied by PBEs/NFPs than an ‘adjusted market assessment approach’. When an ‘expected cost plus a margin approach’ is applied to estimate the amount the transferor would pay on a stand-alone basis for a good or service (or a number of similar goods or services that compose a single unit of account), it would depend on the circumstances whether a margin should be added to the expected cost. If a PBE/NFP is funded on a cost-recovery basis for the goods and services it provides, the margin would be nil (see paragraph 21 for discussion). This does not change the principle involved, but staff thinks this should be clarified in PBE/NFP-specific guidance added to the IFRS on Revenue from Contracts with Customers, if the Boards were to propose requiring performance obligations to be

measured by allocating the transaction price to all separate performance obligations using a relative stand-alone selling price basis. In contrast, when a PBE/NFP sells goods or services on a commercial basis (e.g., to subsidise the costs of other goods or services it provides at less than full cost recovery), if an ‘expected cost plus a margin approach’ needed to be applied to estimate the stand-alone selling price of those goods or services, it would be appropriate to include a margin on cost.

20. In October 2010, the AASB and FRSB tentatively agreed that, to qualify as a performance obligation, a promise to provide goods or services must involve a sufficiently specific stipulation regarding the entity’s promised performance, which enables reasonably objective identification of when a performance obligation has been satisfied.¹¹ An implication of that tentative decision is that, if a promise to provide goods or services is sufficiently specific to qualify as a performance obligation, a PBE/NFP should generally be capable of estimating with sufficient reliability the estimated cost to provide goods or services that satisfy the performance obligation.
21. If an ‘expected cost plus a margin approach’ is used to estimate the stand-alone selling price of a good or service provided in a transaction for the provision of different goods or services, and a margin of nil is added (as discussed in paragraph 19), a question arises whether that treatment would represent a substantive departure from the IFRS on Revenue from Contracts with Customers. AASB staff observe that when an entity obtains different margins on costs for different goods or services it provides, adding the relevant margin on expected cost (as proposed by the IASB ED) is necessary for stand-alone selling prices to be faithfully reflected in the measurement of the different performance obligations. However, when an entity does not obtain a margin on cost as consideration for providing stipulated goods or services, adding no margin would also faithfully reflect the stand-alone selling prices.
22. Based on the discussion above, AASB staff think it should generally be workable for PBEs/NFPs to allocate the transaction price to all separate performance obligations using a

¹¹ The Boards also tentatively agreed on the aspects that would constitute a sufficiently specific stipulation (page 18 of the minutes of that joint Board meeting provides details).

relative stand-alone selling price basis, often by applying an ‘expected cost plus a margin¹² approach’. Whether that measurement approach should be applied to performance obligations is affected by the issue discussed in AASB Agenda Paper 10.6 /FRSB Agenda Paper B7.6.

Question for Board members

Q1 Do you agree that, if it were unnecessary to depart from the IASB ED’s proposed measurement approach for performance obligations in order to deal appropriately with transactions with non-exchange components (discussed in AASB Agenda Paper 10.6 /FRSB Agenda Paper B7.6), there is not a PBE/NFP-specific application issue that warrants departing from the IASB proposal?

¹² Adding a margin only where applicable.

APPENDIX A: Extract from IASB ED on Revenue from Contracts with Customers—Evidence of Stand-alone Selling Prices of Goods or Services
(referred to in paragraph 18 of this paper)

ED Text

“The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately. ... If a stand-alone selling price is not directly observable, an entity shall estimate it.” (paragraph 51)

“When estimating stand-alone selling prices, an entity shall maximise the use of observable inputs and shall apply estimation methods consistently for goods or services with similar characteristics. Suitable estimation methods include the following:

- (a) expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add the margin that the entity would require for that good or service; and
- (b) adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity’s competitors for similar goods or services and adjusting those prices as necessary to reflect the entity’s costs and margins.” (paragraph 52)

Basis for Conclusions Text

“The boards confirmed that stand-alone selling prices would sometimes need to be estimated in order to achieve the objective of recognising revenue when goods or services are transferred to the customer. An alternative approach of allocating consideration only to those performance obligations for which the entity has directly observable prices would not always meet that objective.” (paragraph BC116)

“Compared with the proposals in the discussion paper, there would be fewer instances under the proposed requirements in which the transaction price would be allocated using estimates of stand-alone selling prices. That is because under the proposed requirements, entities allocate the

transaction price only to separate performance obligations for distinct goods or services rather than potentially to every performance obligation in the contract.” (paragraph BC117)

“The boards ... will not preclude or prescribe any particular method for estimating a stand-alone selling price so long as the method:

- (a) is consistent with the basis of a stand-alone selling price (ie the price at which the entity would sell the distinct good or service if it were sold separately to the customer); and
- (b) maximises the use of observable inputs.” (paragraph BC120)