



Staff Paper

Feb 2011, AASB Agenda Paper 10.6 / FRSB Agenda Paper B7.6

Income from Non-Exchange Transactions – Measurement of Transactions with Exchange and Non-Exchange Components

1. This paper discusses applying the measurement attribute for performance obligations proposed by the IASB ED on Revenue from Contracts with Customers to transactions with ‘exchange’ and ‘non-exchange’ components. It does not apply to the measurement of financial liabilities arising from transactions with ‘non-exchange’ components, if those financial liabilities would be accounted for under the domestic Standards incorporating IFRS 9 *Financial Instruments*.
2. AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* discusses transactions with ‘exchange’ and ‘non-exchange’ components. It says:

“There is a further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases the entity determines whether there is a combination of exchange and non-exchange transactions, each component of which is recognised separately.” (paragraph 11)

“Where an asset is acquired by means of a transaction that has an exchange component and a non-exchange component, the entity recognises the exchange component according to the principles and requirements of other Australian Accounting Standards / NZ IFRSs. The non-exchange component is recognised according to the principles and requirements of this Standard. In determining whether a transaction has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.” (paragraph 42)

3. In respect of a transaction involving more than one obligation, the IASB ED proposes allocating the transaction price (consideration received or receivable) across the various obligations, based on the stand-alone selling prices. Under that proposed approach, any discount to the customer from contracting for the supply of multiple goods or services

(deliverables) would be allocated to each performance obligation, weighted according to the stand-alone selling price of each deliverable. The IASB ED does not contemplate transfers that, in part, do not give rise to obligations of the recipient (transactions with ‘non-exchange components’).

4. Indeed, taking the approach proposed in paragraph 3 would raise liability measurement issues that would not arise under the IASB ED on Revenue from Contracts with Customers. If the IASB ED’s approach of allocating the transaction price across the various obligations, based on the stand-alone selling prices, were applied to transactions with ‘non-exchange components’, it would be necessary to specifically identify each component of the transaction, including the non-exchange component. Each obligation would need to be measured as an independent variable (i.e., as a direct measurement rather than an allocated amount), in order to identify the amount of a ‘non-exchange’ component to be recognised as income as at the date of the transaction. However, this would require a distinction to be made between ‘exchange’ and ‘non-exchange’ components of the transaction.
5. Alternatives for dealing with this issue include:
 - (A) Modify the IASB ED’s proposed approach of measuring separate performance obligations at contract inception on a relative stand-alone selling price basis, by measuring each obligation at its stand-alone selling price (i.e., not its *relative* stand-alone selling price) and measuring the non-exchange component as the residual (i.e., by deducting the sum of the stand-alone selling prices of all the obligations from the transaction price);
 - (B) If a transaction has a non-exchange component, apply a direct measurement approach to all components (including all obligations) using the measurement attribute in IAS 37 (fulfilment value)¹;

¹ (except those covered by another Standard such as IAS 19 *Employee Benefits*)

- (C) Focus on the nature of the entity (as a PBE/NFP) and apply a direct measurement approach, by using the measurement attribute in IAS 37 (fulfilment value), for all non-financial liabilities of PBEs/NFPs²; and
- (D) Apply the IASB ED's proposed approach and disregard the non-exchange component. That is, allocate the transaction price across the various obligations, based on their stand-alone selling prices, and attribute none of the transaction price to the non-exchange component.

These alternatives are discussed below.

Alternative (A)

- 6. Under Alternative (A), each obligation is measured at its stand-alone selling price and the non-exchange component is measured as the residual (i.e., by deducting the sum of the stand-alone selling prices of all the obligations from the transaction price).
- 7. As noted in paragraph 4, for transactions with 'non-exchange components', it would be necessary to specifically identify the non-exchange component to faithfully represent the nature of the transaction. Doing so would therefore require a distinction between exchange and non-exchange components, and a definition of each. Because of the pervasive implications of liability measurement, distinguishing exchange and non-exchange components of transactions would seem to conflict with applying the staff's view in AASB Agenda Paper 10.2 / FRSB Agenda Paper B7.2 that, ideally, the scope of the revised ED (and the treatment of a transaction) should not be based on the exchange or non-exchange nature of a transaction. In addition, it would retain the practical difficulties with articulating clearly the distinction between exchange and non-exchange transactions.
- 8. AASB staff consider that it would be infeasible to conform to the IASB ED's proposed approach of measuring separate performance obligations at contract inception on a *relative* stand-alone selling price basis to account for all components of the transaction. This is because it would require the stand-alone selling price of each component of the

² (except those covered by another Standard such as IAS 19 *Employee Benefits*)

transaction, including the non-exchange component, to be estimated. The non-exchange component of a transaction does not have a stand-alone selling price because it does not represent a promise to provide goods or services in return. This is illustrated in Example 1.

Example 1—Multiple Element Arrangement Including a Donation

9. The Sandtrap Country Golf Club (a PBE/NFP) has facilities that include a restaurant and accommodation. As a fundraiser, it sells packages that include one night’s accommodation and a set-menu dinner for two at a total cash price of \$400. Table 1 sets out the stand-alone selling price of each of those performance obligations. The accommodation and dinner are identified as separate performance obligations because they could be used separately, even though that is unlikely. The club does not make a sufficiently specific promise regarding how the donated funds will be used for a performance obligation to arise from the donation.

| TABLE 1 | | | |
|---------------------------|----------------------|---------------|-----------------|
| Item | Accommodation | Dinner | Donation |
| Stand-alone selling price | \$150 | \$120 | \$130* |

* The implicit amount of the donation is a residual because it has no stand-alone selling price.

Alternative (B)

10. If a transaction has a non-exchange component, applying a direct measurement approach to all components (including all obligations)³ using the measurement attribute in IAS 37 would give rise to the advantages and disadvantages of using that attribute noted in AASB Agenda Paper 10.5 / FRSB Agenda Paper B7.5.
11. In the case of transactions with a non-exchange component, a PBE/NFP-specific reason for applying this alternative approach is that such transactions are far more prevalent for

³ (except those covered by another Standard such as IAS 19 *Employee Benefits*)

PBEs/NFPs than for profit-seeking entities. In addition, for the reason described in paragraph 8, staff consider it is infeasible to apply the IASB's proposed relative stand-alone selling price approach to measure each component of a transaction with a non-exchange component.

12. A significant disadvantage of Alternative (B) is that performance obligations would be measured differently according to whether the transaction has a non-exchange component.

That is:

- (a) if such a component does not exist, the obligations would be measured at their relative stand-alone selling prices; but
- (b) if such a component does exist, each component of the transaction (including each obligation) would be measured at an amount based on the entity's own settlement cost.

13. Like Alternative (A), this alternative requires a distinction between exchange and non-exchange components of a transaction. (Its difference from Alternative (A) lies in the measurement attribute that would be used.) Therefore, its adoption would seem incompatible with the staff's view in AASB Agenda Paper 10.2 / FRSB Agenda Paper B7.2 that, ideally, the scope of the revised ED (and the treatment of a transaction) should not be based on the exchange or non-exchange nature of a transaction.

Alternative (C)

14. This alternative extends the measurement attribute in Alternative (B) to apply to all transactions of PBEs/NFPs. It applies a direct measurement approach, by using the measurement attribute in IAS 37 (fulfilment value), for all non-financial liabilities of PBEs/NFPs⁴. [Note that IAS 37 requires risks and uncertainties to be taken into account in reaching the best estimate of a provision (paragraph 42) and that the discount rate applied to provisions reflects current market assessments of the risks specific to the liability (paragraph 47). At this meeting, Board members are not asked to decide whether the fulfilment value approach in Alternative (C) should take into account risk. At this stage,

⁴ (except those covered by another Standard such as IAS 19 *Employee Benefits*)

Board members are asked to focus on the broad choices between the four Alternatives discussed in this paper.]

15. In other words, this alternative adopts a different measurement approach (compared with that proposed in the IASB ED on Revenue from Contracts with Customers) based on the nature of the entity, rather than the nature of the transaction. The identification of an entity as a PBE/NFP seems far less controversial than the exchange/non-exchange distinction, and is relied upon in the application of a number of AASB and FRSB Standards.
16. The purposes of Alternative (C) are to:
 - (a) address the problem noted in paragraph 8 with conforming to the IASB ED's proposal to measure separate performance obligations at contract inception on a relative stand-alone selling price basis when the transaction has a non-exchange component;
 - (b) assist with achieving the staff's proposal that the scope of the revised ED should not be based on whether transactions are exchange or non-exchange; and
 - (c) overcome the disadvantage of Alternative (B) that performance obligations would be measured differently according to whether the transaction has a non-exchange component.
17. Some argue that Alternative (C) is necessary to ensure PBEs/NFPs recognise income immediately for non-exchange components of transactions, while avoiding defining the scope of the revised ED in terms of non-exchange components of transactions.
18. However, the reason for the different measurement approach relates only to transactions with a non-exchange component. Despite that, under Alternative (C), the different measurement approach would be extended to all transactions of PBEs/NFPs to achieve the purpose in paragraph 16(b).
19. It may be argued that transactions with a non-exchange component are not sufficiently pervasive to justify applying Alternative (C), given the problem noted in paragraph 18. Many transactions entered into by PBEs/NFPs are not different from those entered into by

for-profit entities, and treating the same transactions differently according to the entity's classification would lack comparability. Mitigating this concern is the likelihood that, if PBEs/NFPs were to use stand-alone selling prices to measure performance obligations, those prices would need to be estimated using the expected cost of settling those obligations (see AASB Agenda Paper 10.5 / FRSB Agenda Paper B7.5). Therefore, the significance of departing from the IASB ED's approach to measuring performance obligations (by using cost-based measurement) might often be minimal in practice.

20. Supporters of Alternative (C) also note that the IASB ED on Revenue from Contracts with Customers proposes measuring return obligations at an amount consistent in principle with the measurement requirements of IAS 37 (that is, measuring the liability at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, based on the expected value of the outflows). Measuring performance obligations of PBEs/NFPs using the measurement attribute in IAS 37 would therefore result in PBEs/NFPs using a single measurement principle for performance obligations and return obligations.

Alternative (D)

21. Under this alternative, any non-exchange component of a PBE's/NFP's transaction would be disregarded. The transaction price would be allocated only to the various obligations, based on their stand-alone selling prices.
22. For example, in the circumstances described in Example 1, the transaction price of \$400 would be allocated to the obligation to provide accommodation and the obligation to provide dinner for two, as follows:

TABLE 2

| Item | Stand-alone selling price | Calculation of relative stand-alone selling price | Measure (initial carrying amount) of obligation |
|---------------|---------------------------|---|---|
| Accommodation | \$150 | $(150/270) \times 400$ | \$222 |
| Dinner | \$120 | $(120/270) \times 400$ | \$178 |
| Donation | – | – | – |
| Total | \$270 | | \$400 |

23. This alternative would conform to the approach in the IASB ED and should generally be simple to apply. In addition, under Alternative (D) only, any error in measuring a performance obligation would not affect income recognised as at the date of the original transaction, because income would only be recognised when obligations arising from the transaction are satisfied. This would be consistent with an objective of the IASB ED on Revenue. However, the IASB ED does not contemplate transactions with customers having a non-exchange component.
24. When a transaction has a non-exchange component, treating the entire transaction price (the customer's consideration) as relating only to obligations would not be representationally faithful. In some transactions of PBEs/NFPs, a non-exchange component might be quite significant in amount.

Overall Comparison of Alternatives

25. Alternative (A) and Alternative (B) require a distinction between exchange and non-exchange components of a transaction. For the reasons discussed in AASB Agenda Paper 10.2 / FRSB Agenda Paper B7.2, such a distinction is inherently difficult to define and identify in practice. The staff's recommendation in that paper is that the scope of the revised ED that succeeds ED 180/ED 118 should not be based on non-exchange transactions. Accordingly, the staff does not support Alternative (A) or Alternative (B).

26. Alternative (C) does not create the problem mentioned in paragraph 25. Its main apparent flaw is that a different measurement approach from that proposed in the IASB ED would apply to all performance obligations of PBEs/NFPs, although the purpose of that difference would be to cater for a sub-set of those entities' transactions (i.e., transactions with a non-exchange component). This would result in a lack of comparability in the measurement of identical transactions undertaken by for-profit entities and PBEs/NFPs (i.e., transactions without such a component). However, as noted in paragraph 19, in practice the difference from the IASB ED should often be insignificant.
27. The main apparent flaw of Alternative (D) is that it treats the entire transaction price as relating only to obligations, even when a transaction has a non-exchange component. Staff think this is a more serious flaw than the flaw of Alternative (C) mentioned in paragraph 26. This is because staff regards a lack of representational faithfulness as a greater flaw than a lack of comparability of measurement attributes. In contrast to Alternative (D), applying Alternative (C) does not fail to depict a component of a transaction.
28. Another problem with Alternative (D) is that the treatment of a given non-exchange transfer would differ depending on it occurs as a component of a transaction or in a separate transaction. Thus, the structuring⁵ of transactions involving identical economic elements (performance obligations and non-exchange transfers) would determine the timing of income recognition. For example, in Example 1, if the transferor purchased the accommodation and dinner for \$270 and made a separate donation of \$130, under Alternative (D) the donation would be recognised as income immediately because that transaction does not give rise to any obligations. In contrast, if the donation were made as a component of a transaction, it would not be recognised at all. As illustrated in Table 2, the entire transaction price would be allocated to the two performance obligations.
29. In view of the concerns in paragraphs 27 – 28, and because transactions including a significant subsidy component would not be unusual for PBEs/NFPs, AASB staff think Alternative (C) should be preferred to Alternative (D).

⁵ In this context, this word is not used with its pejorative connotation.

Questions for Board members

- Q1** Do you agree that, to deal appropriately with transactions with non-exchange components, all performance obligations and other non-financial liabilities of PBEs/NFPs should be measured under Alternative (C) above, namely, using the measurement attribute in IAS 37 (fulfilment value)?
- Q2** If you disagree with the staff's recommendation, which Alternative do you prefer, and why? Are there any other alternatives that should be considered?