



Staff Strategy Paper

March 2011, Agenda Paper J3.3

IFRS on *Revenue from Contracts with Customers* – PBE/NFP Issues

Purpose of this Agenda Item

1. This paper discusses how to address public benefit entity (PBE) /not-for-profit entity (NFP) issues that might arise in issuing domestic Standards that incorporate the forthcoming IFRS on *Revenue from Contracts with Customers*. The FRSB held a preliminary discussion of the need to address this issue at its February 2011 meeting. An Update on that FRSB discussion is provided in Agenda Paper J3.4.
2. The purpose of this agenda item is to identify a strategic direction in response to the abovementioned IFRS, and does not include identifying all PBE/NFP-specific issues or deciding PBE/NFP-specific modifications to the IFRS to resolve the issues. Staff identify some potential PBE/NFP-specific issues arising from IASB ED/2010/6 *Revenue from Contracts with Customers*¹ (see the Appendix to this paper) to inform a discussion of whether PBE/NFP-specific issues can be resolved in the short term.

Overall Staff Views

3. AASB and NZICA staff recommend that, in the short term (i.e., in the domestic Standards incorporating contemporaneously the IFRS on *Revenue from Contracts with Customers*), the Boards should retain without amendment the Standards presently applying to PBEs/NFPs on revenue (whether revenue from exchange transactions or revenue from non-exchange transactions).

Background

4. The IASB aims to issue an IFRS on *Revenue from Contracts with Customers* in June 2011. The general approach of the AASB and FRSB to adopting new or revised IFRSs is to issue a domestic Standard that incorporates (without amendment for for-profit entities) each

¹ A pre-ballot draft of the IFRS has yet to be prepared and circulated. Therefore, the staff considered IASB ED/2010/6 and recent IASB meeting summaries to identify potential PBE/NFP-specific issues.

- IFRS without delay. The Boards also endeavour to include PBE/NFP-specific modifications to the IFRS, either concurrently or within a short period of time.
5. Where it is infeasible to make all PBE/NFP-specific modifications to the IFRS quickly, the Boards have deferred full consideration of those potential modifications and activated a project to address PBE/NFP-specific issues over a longer period. That longer period is limited, at the very latest, to the date by which application of the new or revised IFRS becomes mandatory.
6. Where it is infeasible to make all PBE/NFP-specific modifications to the IFRS quickly, the Boards can make an IFRS applicable to PBEs/NFPs by either:
- (a) following a two-step process, under which the Boards would make:
 - (i) the IFRS applicable to all entities including PBEs/NFPs when they issue the domestic Standard, and make only limited PBE/NFP-specific modifications² at inception; and
 - (ii) additional PBE/NFP-specific modifications at a later stage; or
 - (b) following a one-step process by wholly deferring its application by PBEs/NFPs and deferring changing the existing requirements for PBEs/NFPs until the Boards have completed their consideration of all PBE/NFP-specific issues.
7. Advantages of following a two-step process are that during the early adoption period:
- (a) a new IFRS's important improvements to existing requirements are not deferred until all PBE/NFP-specific issues are considered; and
 - (b) it minimises the extent to which a lack of transaction neutrality occurs while the PBE/NFP-specific project is carried out.
8. Disadvantages of following a two-step process are that:
- (a) the requirements for PBEs/NFPs are changed on multiple occasions, leading to additional preparer costs and possibly confusion; and

² Those modifications could include scoping out some transaction types.

- (b) it involves a risk that limited changes to practice adopted in the first step could give rise to unintended consequences that would be identified only from a comprehensive examination of all PBE/NFP-specific issues.
9. An example of the Boards' application of a one-step process described in paragraph 6 is their process to adopt forthcoming IFRS 10 *Consolidated Financial Statements*. The Boards decided to defer in full the application of IFRS 10 by PBEs/NFPs until a project on the PBE/NFP-specific issues is completed.

Implications of Project on Income from Non-Exchange Transactions

10. The AASB is effectively treating the project on Income from Non-Exchange Transactions as the analysis of PBE/NFP-specific issues arising from the forthcoming IFRS on *Revenue from Contracts with Customers*. This observation is based on:
- (a) the Boards' decision in their joint meeting in October 2010 to continue working on a model for identifying PBE/NFP liabilities arising from the receipt of assets in non-exchange transactions:
 - (i) based on the IASB's guidance on performance obligations in IASB ED/2010/6; but
 - (ii) modifying that guidance to the extent necessary to address PBE/NFP-specific issues; and
 - (b) the AASB's decisions in February 2011 that:
 - (i) the revised ED succeeding ED 180/ED 118 should apply to revenue recognition by PBEs/NFPs in the public and private sectors, and the scope of the revised ED should not be limited to non-exchange transactions; and
 - (ii) assets and liabilities within the scope of the revised ED should initially be measured in accordance with the measurement requirements of the relevant IFRS, except for limited PBE/NFP-specific modifications.

(An extract from the draft minutes of the AASB's February 2011 meeting is attached as Agenda Paper J3.5.)

11. The FRSB has yet to consider in detail the issues discussed by the AASB in February 2011 and which led to the decisions noted in paragraph 10(b).
12. Although the AASB and FRSB are differently placed in considering issues in their joint project on Income from Non-Exchange Transactions, that difference does not necessarily affect the Boards' short-term strategy for dealing with the IFRS on *Revenue from Contracts with Customers*. This is because, based on the ambitious staff plan in AASB Agenda Paper 10.9 / FRSB Agenda Paper B7.9 for the Boards' February 2011 meetings, a Standard resulting from the project on Income from Non-Exchange Transactions would not be issued until the first half of 2012.³
13. Therefore, in the short term, the AASB and FRSB/XRB need to decide the scope of their respective Standards that incorporate the IFRS on *Revenue from Contracts with Customers*, and the nature of any PBE/NFP-specific modifications to the IFRS. They can take a common approach to this short-term step, regardless of whether they make different decisions about the Standard developed through the project on Income from Non-Exchange Transactions.
14. Accordingly, the staff analysis below is separated into short-term strategy issues and longer-term strategy issues.

Staff Analysis

Short-term strategy

15. Based on the foregoing, staff have identified the following alternative strategies for dealing with an IFRS on *Revenue from Contracts with Customers* in the short term:
 - (A) Make the domestic Standards incorporating that IFRS applicable to all entities in the short term without any PBE/NFP-specific modification;

³ At its February 2011 meeting, the AASB decided not to identify estimated dates for issuing a revised ED and subsequent Standard. Nevertheless, AASB staff consider that the earliest possible time for issuing the Standard developed from the revised ED would be the first half of 2012.

- (B) Make the new IFRS requirements applicable to PBEs/NFPs, but only in respect of ‘exchange transactions’ or transactions with a primary purpose of generating net cash inflows. No other PBE/NFP-specific modifications would be made to the IFRS. A minor variation of this ‘alternative’ is to provide guidance on the meaning of ‘customer’ in a PBE/NFP context; and
- (C) Retain without amendment the Standards presently applying to PBEs/NFPs on revenue (whether revenue from exchange transactions or revenue from non-exchange transactions).

These alternatives are discussed below.

Alternative A

16. In its October 2010 submission on IASB ED/2010/6, the FRSB said:

“If the proposed standard were to be applicable to non-public entities, but for disclosure concessions, the FRSB’s expectation is that little, if any, modification would be appropriate. This is because the proposed standard specifies the accounting for revenue arising from contracts with customers which are primarily exchange transactions rather than accounting for revenue from non-exchange transactions such as some forms of government grant or donations. However, some consideration will need to be given to whether or not the term ‘contract’ is defined in a manner that would ensure that the proposed standard would apply to situations where the ‘customer’ is not the provider of funds, such as in the case of a private hospital that receives funding from the government to provide health services to a particular area of the public or particular patients where the ‘customer’/patient is not the one paying for the services.”

17. That view largely supports the approach in Alternative A. At the FRSB’s February 2011 meeting, some FRSB members expressed a view that one option would be to limit the scope of the Standard to those contracts with customers that are exchange transactions.
18. At the joint meeting of the AASB and FRSB in October 2010, the Boards tentatively agreed that the IFRS on *Revenue from Contracts with Customers* could be regarded as applying to at least some non-exchange transactions. In the context of their joint project on Income from Non-Exchange Transactions, the Boards tentatively decided that “if the IASB issues guidance on performance obligations consistent with that in its ED on

Revenue from Contracts with Customers, ... clarification should be included, in a PBE/NFP context, of ... the meaning of ‘customer’ and the relevance of the notion of ‘customer’ in the IFRS on *Revenue from Contracts with Customers*. ... it is unnecessary to specify which entity should be regarded as the ‘customer’, because the focus should be on the nature and extent of a PBE’s/NFP’s performance obligations.”

19. At that joint meeting, the Boards also noted that the need for PBE/NFP-specific guidance on the meaning of ‘customer’ applies to exchange transactions as well as non-exchange transactions. If PBE/NFP-specific guidance were added to assist with application of the IFRS’s requirements to exchange transactions of PBEs/NFPs (for example, to clarify that when services are provided to third parties at the direction of a purchaser, the purchaser nonetheless qualifies as a customer), such guidance might broaden the meaning of ‘customer’ from that previously interpreted by the FRSB (as referred to in paragraph 16). If so, a domestic Standard including that clarification:
- (a) probably would be viewed as applying to non-exchange transactions; and
 - (b) therefore would probably require non-exchange transactions to be scoped out of the Standard, at least until the longer term project based on Income from Non-Exchange Transactions is completed.
20. AASB and NZICA staff support the tentative decision of the Boards in October 2010 (referred to in paragraph 18) and therefore think it would be inappropriate to make the domestic Standards incorporating the IFRS on *Revenue from Contracts with Customers* applicable to all entities in the short term without any PBE/NFP-specific modification.

Question for Board members

- Q1** Do you agree that it would be inappropriate to make the domestic Standards incorporating the IFRS on *Revenue from Contracts with Customers* applicable to all entities in the short term without any PBE/NFP-specific modification?

Alternative B

21. The Boards could make the new IFRS's requirements applicable to PBEs/NFPs, but only in respect of 'exchange transactions' or transactions with a primary purpose of generating net cash inflows. (The second category of transactions could be referred to instead of 'exchange transactions', given concerns expressed about the ambiguity of the distinction between 'exchange' and 'non-exchange' transactions.) Apart from that scope limitation, the Board could decide to make no other PBE/NFP-specific modifications to the IFRS.
22. This approach would be consistent with a view that only non-exchange transactions would present PBEs/NFPs with difficulties in applying the IFRS on *Revenue from Contracts with Customers*. Supporters of this approach note that neither AASB 118 *Revenue* nor NZ IAS 18 *Revenue* includes PBE/NFP-specific modifications.
23. However, the IFRS on *Revenue from Contracts with Customers* would differ from IAS 18 in some important respects affecting PBEs/NFPs. Unlike IAS 18, it places heavy emphasis on contracts with customers. In addition, it takes a customer perspective on whether goods or services have been provided by the entity. In this regard, the AASB's submission on IASB ED/2010/6 argued:

“In some contracts control of the good or service never passes to the customer. It passes to the customer's agent or a defined beneficiary. For example, take a private hospital or school where the government or a health fund pays for a particular student or a patient. These proposals would be able to be applied to more situations if the focus was instead on when the entity loses control of assets (which in most cases will be the same point the customer gains control) or an explicit acknowledgement could be included that control may pass to a third party at the request of the customer.” (page 7)

The FRSB's submission on IASB ED/2010/6 made a similar comment (pages 18 – 19).

24. In view of these aspects in paragraph 23, AASB and NZICA staff think that, if the Boards were to make the new IFRS's requirements applicable to PBEs/NFPs, but only in respect of 'exchange transactions' or transactions with a primary purpose of generating net cash inflows, it would be necessary to provide guidance on the meaning of 'customer' in a PBE/NFP context.

25. In addition to the PBE/NFP-specific modification to clarify the meaning of ‘customer’ and the relevance of the notion of ‘customer’ in the IFRS on *Revenue from Contracts with Customers*, the AASB tentatively decided in February 2011 to make a PBE/NFP-specific modification to require performance obligations to be measured directly at the stand-alone selling prices of the unit of account for the usual sale of the promised goods or services. The purpose of this latter PBE/NFP-specific modification to the IFRS on *Revenue from Contracts with Customers* is to account appropriately for transactions with a donation (or other non-exchange) element. Staff note that the need for this modification arises only in respect of transactions with a non-exchange element, and therefore the modification is compatible with adopting Alternative B.

Question for Board members

- Q2** Do you agree that that, if the Boards were to make the new IFRS’s requirements applicable to PBEs/NFPs, but only in respect of ‘exchange transactions’ or transactions with a primary purpose of generating net cash inflows, it would be necessary to provide guidance on the meaning of ‘customer’ in a PBE/NFP context?

Alternative C

26. Under Alternative C, the Boards would retain without amendment the Standards presently applying to PBEs/NFPs on revenue (whether revenue from exchange transactions or revenue from non-exchange transactions).
27. An important reason for adopting Alternative C is that it would not require PBEs/NFPs to change their accounting policies for revenue recognition more than once. It is likely that developing comprehensive guidance for all revenue transactions of PBEs/NFPs in a longer-term project will lead to further or amended PBE/NFP-specific modifications in respect of revenue from ‘exchange transactions’.⁴

⁴ PBE/NFP-specific modifications in respect of revenue from ‘exchange transactions’ are referred to, because Alternative C is contrasted here with Alternative B, which would apply the IFRS only to ‘exchange transactions’ in the short term.

28. Another important reason for adopting Alternative C is the tentative view of the AASB that the treatment of transactions giving rise to revenue should not differ according to whether the transaction is exchange or non-exchange. It would be inconsistent with that view to make the IFRS on *Revenue from Contracts with Customers* applicable to exchange transactions but not non-exchange transactions. Closely related to this reason is the widely-expressed concern that the distinction between ‘exchange’ and ‘non-exchange’ transactions in AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* is unclear, as evidenced by the difficulties encountered by the Boards in clarifying that distinction. An alternative expression to ‘exchange transactions’ is transactions with a primary purpose of generating net cash inflows. However, that expression has not been exposed for public comment, and may give rise to other difficulties in interpretation.
29. Agenda Paper J3.6 discusses transfers to PBEs/NFPs accompanied by enforceable obligations to provide goods or services that will cost more to fulfil than the amount of the transfer, because the cost of those goods or services is expected to be recovered from other sources. In respect of these transfers, some staff conclude that resolving whether a PBE/NFP-specific modification should be made regarding possible recognition of liabilities for ‘onerous contracts’ would be unlikely to be feasible in the short term. (As discussed in Agenda Paper J3.6, some other staff disagree that these transfers involve ‘contracts with customers’ and therefore see this as a non-issue.) Therefore, some staff think these transfers are a reason to exclude PBEs/NFPs from the scope of the domestic Standards incorporating the IFRS on *Revenue from Contracts with Customers* until this issue is explored fully.
30. The reasons against adopting Alternative C are, effectively, the reasons given above for adopting the other alternatives. Further, Alternative C effectively creates a further suite of Standards and if this approach is used for a number of Standards, it may become difficult to manage the links between Standards.
31. AASB and NZICA staff recommend adopting Alternative C because they think the reasons in paragraphs 27 – 29 for its adoption are more persuasive than the reasons for the other alternatives.

32. If the staff's recommendation were accepted:
- (a) the implications in Australia are that, for the time being, NFPs would continue to account for:
 - (i) exchange transactions under AASB 118 *Revenue*; and
 - (ii) non-exchange transactions under AASB 1004 *Contributions*; and
 - (b) the implications in New Zealand are that, for the time being, PBEs would continue to:
 - (i) account for transactions within the scope of NZ IAS 18 *Revenue* under that Standard; and
 - (ii) apply the hierarchy in NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to other transactions giving rise to revenue.

Question for Board members

- Q3** Do you agree that the Boards should retain without amendment the Standards presently applying to PBEs/NFPs on revenue (whether revenue from exchange transactions or revenue from non-exchange transactions)?

Longer-term strategy

33. As mentioned above, the AASB is effectively treating the project on Income from Non-Exchange Transactions as the analysis of PBE/NFP-specific issues arising from the forthcoming IFRS on *Revenue from Contracts with Customers*.⁵ Because that analysis would be comprehensive and take until at least 2012 to complete, for the AASB at least, it represents the longer-term strategy for addressing PBE/NFP-specific revenue issues.

⁵ In October 2010, the AASB and FRSB noted that the meaning and significance of 'customer' need clarifying for PBEs/NFPs in respect of exchange transactions as well as non-exchange transactions. The staff plans to address that issue in respect of all transactions of PBEs/NFPs within the project. The staff is not aware of any PBE/NFP-specific issues arising from the IFRS on *Revenue from Contracts with Customers* that would not be addressed in this project.

34. From a New Zealand perspective, the FRSB or XRB would need to decide whether that approach would be undertaken jointly. At the February 2011 FRSB meeting, FRSB members expressed reservations about whether to make decisions on issues underpinning that approach with the imminent commencement of the XRB.
35. Based on these considerations, the staff would support:
- (a) the AASB continuing with its current approach; and
 - (b) the FRSB participating in the project until the commencement of the XRB. This would have the advantage that, if the XRB decides to adopt a similar approach to the AASB, it has the benefit of the FRSB's continued work on the project, including considering issues arising in a New Zealand context.

Question for Board members

Q4 How do the Boards wish to progress this project until 30 June 2011 – the anticipated start date for the XRB?

APPENDIX A: Potential PBE/NFP-Specific Issues in Applying the forthcoming IFRS *Revenue from Contracts with Customers***Introduction**

- A1. This Appendix notes some potential PBE/NFP-specific issues arising from IASB ED/2010/6 *Revenue from Contracts with Customers*. These potential issues have been identified by the AASB, FRSB and some PBE/NFP constituents in their submissions on IASB ED/2010/6 and in the Boards' deliberations in their joint project on Income from Non-Exchange Transactions.
- A2. The purpose of noting these potential issues is to assist the AASB and FRSB in assessing whether PBE/NFP-specific issues can be addressed in the short term (when domestic Standards incorporating the forthcoming IFRS *Revenue from Contracts with Customers* are issued contemporaneously with that IFRS) or need to be addressed subsequently.
- A3. The following discussion includes an update on some tentative decisions made by the IASB and FASB as they redeliberate the proposals in IASB ED/2010/6.

PBE/NFP-specific modifications tentatively agreed by the AASB and FRSB

- A4. The minutes of the AASB-FRSB meeting in October 2010, in relation to the Boards' discussion of Income from Non-Exchange Transactions, include:

“The Boards agreed that work on developing a ‘performance obligations approach’ should proceed on the basis that, if the IASB issues guidance on performance obligations consistent with that in its ED on Revenue from Contracts with Customers, the following modifications to that guidance would be appropriate:

- (a) the basis for identifying separate performance obligations (the ‘unit of account’) should be modified. In this regard, the Boards directed staff to compare identifying the unit of account for PBEs/NFPs as each promise to provide goods or services (each separate ‘contract element’) with the IASB’s proposed unit of account; and

- (b) clarification should be included, in a PBE/NFP context, of:
 - (i) the meaning of ‘customer’ and the relevance of the notion of ‘customer’ in the IFRS on Revenue from Contracts with Customers. The Boards agreed 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;
 - (ii) how specific another party’s enforceable right to receive goods or services must be in order to qualify as a performance obligation of the reporting entity; and
 - (iii) the meaning of ‘enforceability’ in relation to an enforceable promise to provide goods or services to other parties.”

A5. The issue referred in paragraph A4(a) is the proposal in IASB ED/2010/6 that, if an entity promises to transfer more than one good or service, it accounts for each promised good or service as a separate performance obligation only if it is distinct. The ED says a good or service, or a bundle of goods or services, is distinct if either:

- (a) the entity, or another entity, sells an identical or similar good or service separately;
or
- (b) the entity could sell the good or service separately because it both has a distinct function and a distinct profit margin.

A6. The AASB and FRSB agreed that identifying separate performance obligations on the basis of a distinct profit margin would be inappropriate for PBEs/NFPs. In their submissions on IASB ED/2010/6, both Boards commented on the inappropriateness of that principle for PBEs/NFPs (in response to IASB Question 17). However, as explained in paragraphs A7 – A9, recent developments indicate the source of this concern might disappear.

A7. The *IASB Update* for the IASB-FASB meeting in February 2011 noted that, in their redeliberations of the ED’s proposals, the IASB and FASB agreed upon criteria for

identifying separate performance obligations that do not mention distinct profit margins.

The IASB and FASB tentatively decided that an entity should account for a promised good or service as a separate performance obligation if:

- (a) the good or service would be provided to the customer at a different time than other promised goods or services in the contract; and
- (b) the good or service has a distinct function. This is the case if either:
 - (i) the entity regularly sells the good or service separately; or
 - (ii) the customer can use the good or service either on its own or together with resources that are readily available to the customer.

A8. The Boards also tentatively decided that an entity should account for a bundle of promised goods or services as a single performance obligation if the entity provides a service of integrating those goods or services into a single item that the entity provides to the customer.

A9. Therefore, it would appear that potential need for a PBE/NFP-specific modification of the IFRS, outlined in paragraphs A4 – A6, might be removed.

A10. Staff think none of the aspects of the tentatively agreed PBE/NFP-specific modifications set out in paragraph A4(b) should necessarily take a long time to articulate. However, in the February 2011 IASB-FASB meeting, those Boards tentatively decided to amend their proposed definition of a performance obligation by deleting the word ‘enforceable’. AASB staff have received informal advice that this tentative decision does not represent a fundamental change in intended meaning, and was prompted by a desire to avoid overly legalistic interpretations of enforceable obligations (given that performance obligations to customers may be constructive in nature). Nevertheless, this tentative decision, if reflected in the IFRS, could have significant implications for how the IFRS would be interpreted and for the nature of any PBE/NFP-specific guidance on performance obligations. Therefore, it is unclear at this stage how quickly this aspect could be dealt with in domestic Standards that incorporate the IFRS on *Revenue from Contracts with Customers*.

Other potential PBE/NFP-specific issue

- A11. Based on the discussion in paragraphs A4 – A10, it is not clear that a long period of time would be necessary to address PBE/NFP-specific issues arising from the IFRS on *Revenue from Contracts with Customers*. However, Agenda Paper J3.6:
- (a) identifies a potential PBE/NFP-specific issue regarding whether to recognise liabilities for onerous contracts in respect of transfers to PBEs/NFPs accompanied by enforceable obligations to provide goods or services that will cost more to fulfil than the amount of the transfer; and
 - (b) indicates the view of some staff that this issue would be unlikely to be resolved in the short term.