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Transactions other than Exchanges of Equal Value Issues Paper

Objective

1 The objective of this session is to further discuss some issues in relation to the Research project on Transactions other than Exchanges of Equal Value ('TEEV') and in particular:

(a) What is the implication of removing the 'imposed transaction' criterion from the definition of the scope;

(b) Whether the model should aim to achieve a symmetrical treatment of expense and income-generating transactions; and

(c) What the impact on the model should be, when income-generating transactions are subject to conditions (like in the case of most Government grants).

Scope of the project and the 'imposed transaction' criterion

The premise and objective of the model – a short reminder

2 When independent entities enter into exchange transactions, the underlying assumption is that the parties expect to end up at least as well-off, in economic terms, as they were before.

3 For exchange transactions with these characteristics, the accounting model is focused mainly on the recognition of assets and liabilities. Control and present obligation play therefore a fundamental role in the general accounting model.

4 However, the assumption above does not apply to all transactions. In some cases, entities may give (or receive) value without directly receiving (or giving) equal value to the counterparty in return. In other cases, a resource provider may commit to transfer resources to an entity but the entity is required to assume some obligations towards other parties. The intended outcome of the transaction may be different from the maximisation of the profit of the involved parties.

5 Some characteristics commonly associated with these transactions are:

(a) They often involve Government or Government entities, although it is not the intention to restrict the Research project to transactions with Government;

(b) They may be required by law or regulations, so entities do not have the ability to decide whether they want to enter into the transaction, or how much they are willing to give up or accept;

(c) They may not involve only two identifiable parties and the resource provider (e.g. grantor) may often not directly receive the services provided by the resource receiver. The resource provider may have the ability to direct who receives the services in accordance with the resource provider's objectives;

(d) It may not be possible to identify precisely the obligations of the parties or the goods or service being exchanged by one of the parties;

(e) There is also more variation and uncertainty about enforceability because many arrangements may not take the form of legal contracts. For instance, many arrangements with the Government for the provision of resources are non-contractual in nature and their enforceability can be reflected by a range of non-contractual mechanisms, such as legislation, ministerial decisions.

Identifying the set of transactions in scope

6 The starting point of the investigation was that the non-reciprocal nature of the transaction may justify a change in the way the cost of a transaction is allocated. Normally, cost is allocated to depict the consumption of the benefits from a transaction. If the entity does not receive goods or services, or is unable to identify them, then a different approach to cost allocation is needed.

7 A possible conceptual basis considered by the EFRAG Secretariat is that, at least for some categories of non-reciprocal transactions, when a transaction is entered into and no asset or services are directly identifiable (such as taxes or levies), the entity may be receiving forms indirect benefit from the general activities of the other party (generally a Government) - although there is no direct link between the amount paid and the benefit received.

8 Likewise, when the entity is receiving an inflow of resources, these are given not only as consideration for the goods or services provided, but to promote and compensate a general contribution to the society. For instance, an entity receiving a research grant may not be required to transfer the results of its research.

9 The implication of this underlying basis is that in some occasions it would more likely lead to apply a progressive, straight-line recognition of expenses (in the case of recurring payments) rather than a 'point in time' recognition approach in the general model. It seems indeed reasonable to assume, in the absence of other determinable consumption patterns, that services rendered by government are consumed continuously.

10 Developing a different accounting approach requires identifying which set of transactions are in scope and what the common characteristic of this set is. Initially, the EFRAG Secretariat had considered expense-generating transactions such as tax and levies, and had proposed to identify the scope based on the following:

(a) The entities do not exchange equal value; and

(b) The transaction is imposed.

11 The 'imposed' criterion had been considered useful because it mitigated the concern that weakening the present obligation anchor may result in possible reversals of liabilities previously recognised, which are less understandable and relevant to users. The 'imposed' criterion would mean that entities do not have the discretion to avoid payment but they cannot either choose whether and when to consume the services provided by the resource recipient. These features were used in the expense-generating model.

12 However, when considering income-generating transactions, they are generally voluntary. Maintaining an 'imposed' criterion in scoping the project would result in the exclusion of income-generating transaction (and some forms of expense-generating ones such as donations) and would therefore reduce the relevance of the proposed approach.

13 Income-generating transactions other than exchanges of equal value may include transactions with governments (such as grants) as well with non-governmental entities, such as private donations.

14 The EFRAG Secretariat does not necessarily consider that the accounting model needs to be fully symmetrical for income-generating and expense-generating transactions. However, the project requires to maintain a certain degree of consistency in the analysis and approach – the objective is not to develop separate models for each of the transactions. At its February meeting, EFRAG TEG instructed the EFRAG Secretariat to reconsider the scope of the project and in particular to assess the effect of removing the 'imposed' criterion.

15 Appendix 1 presents a typology of transactions that would be included if the 'imposed' criterion is removed. The removal does not seem to significantly change the set of expense-generating transactions in scope of the project.

16 Appendix 2 present an outline of the alternative accounting models for expense and income-generating transactions.

Questions for EFRAG TEG

17 Does EFRAG TEG have comments on the EFRAG Secretariat analysis?

Should the model be fully symmetrical for expense and income-generating transactions?

18 The developed approach for expense-generating transactions (such as tax or duties) can be extended to some forms of income-generating transactions whereby a notion of benefits transferred to the general public may be identified. A government can provide a variety of public to the general public either directly or by funding private organisations, for instance through the provision of grants.

19 Mirroring the approach for expense-generating transactions, the model would favour of a recognition pattern based on a notion of continuous contribution to the benefit of the society at large. This would de-emphasize the notion of transferring the control on the resource as a driver to recognise revenue, when the entity is not required to provide specific assets or goods to an identified party

20 However, there should still be an element of control incorporated in the model. If an income is recognised when the resource provider still has full discretion to avoid the transfer of resources, this would create the possibility of reversals outside the control of the beneficiary. Reversals lessen the predictive value of financial information.

21 In that respect, the EFRAG Secretariat notes that current IAS 20 provides that grants shall not be recognised until there is 'reasonable assurance' that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received

22 Similarly, IFRS 15 similarly includes a 'collectability threshold' to identify whether a contract actually exists: it must be 'probable' that the entity will collect the consideration to which it is entitled.

23 The EFRAG Secretariat has not yet formed definitive views on what the recognition threshold would be and is seeking EFRAG TEG's input. Possible alternatives identify different degrees of certainty:

(a) The probability that the resource will be received and the conditions met (similar to IAS 20);

(b) The enforceability of the arrangement;

(c) The unavoidability of the payments for the resource provider;

(d) The present rights and obligations set up by the legal framework.

24 Some of these recognitions thresholds would create a recognition asymmetry with the model proposed for expense-generating transactions. This could be seen as an example of asymmetrical application of prudence.

25 In EFRAG Secretariat's view, the mere enactment of a law (or the introduction of some other enforcement mechanism, policy or practice, or the making of a statement) setting up a new government grant or contribution is not in itself sufficient to give an entity a right or obligation on a resource from/to the government. The entity must have started conducting an activity to which the law or other enforcement mechanism apply.

Questions for EFRAG TEG

26 Does EFRAG TEG consider that 'asymmetrical production should be considered in the case of income-generating TEEV transactions? If so, which threshold should be considered?

Impact of conditions attached to income-generating transaction: are these a form of performance obligations?

27 Compared to expense-generating transactions such as levies, income-generating transactions are often characterised by the following features:

(a) The receipt of the income is conditional upon meeting certain conditions;

(b) The receipt of the income is not recurring on a yearly basis.

28 At its December meeting, EFRAG discussed the effects of conditions. It was noted that the recipient of grants and similar benefits - assuming it has gained control of the transferred resource - may incur a present obligation when the grant is subject to a future condition of either delivering goods or services to third parties or returning to the transferor future economic benefits or service potential. Some conditions are linked to the operations of the entity (e.g. receiving a grant to do research in a specified area).

29 When conditions could be seen to create a form of performance obligation for the beneficiary, it could be worthwhile to consider a performance obligation model, akin to that in IFRS 15 *Revenue from Contracts with Customers.* The following section further discusses whether and when conditions could create forms of performance obligations.

30 IFRS 15 defines a 'performance obligation' as a promise in a contract with a customer to transfer to the customer either a good or service (or a bundle of goods or services) that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations.

31 Given the characteristics of the transactions we are considering, it may be necessary to broaden the definition of performance obligation and discuss the implication of a number of other aspects:

(a) In IFRS 15, normally the party paying the consideration is also receiving the goods or services. Here it may not be the case: it may not be obvious who the 'customer' or end beneficiary is, and it may include a multitude of parties.;

(b) The goods or services to be supplied may not be specified in detail and 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. A performance obligation approach is more easily applied to transactions where there is a high degree of specificity over the obligations of the parties to the transaction and does not work well for transactions where the terms and conditions of the transaction are less specific;

(c) More uncertainty about enforceability because many agreements will not be legal contracts. A performance obligation approach for grants and similar benefits would need to take a broad view of binding arrangements in the public sector;

(d) In IFRS 15, performance obligations are normally created by contractual agreements, not by legislative requirements. For instance, a legal warranty provision does not give rise to a performance obligation. For grants and other transfers, the conditions often arise out of legal provisions.

32 In the following paragraphs, we illustrate what characteristics would make conditions attached to governments grants more similar to performance obligations.

The conditions must have substance

33 A term in a transfer agreement that requires the entity to perform an action that it has anyway no alternative but to perform, may lead to conclude that the term is in substance neither a condition nor a restriction and does not impose on the recipient entity a performance obligation. An example of that would be a general condition of compliance with applicable laws.

The conditions must have economic effects for the grantee if not complied with

34 The recipient must incur a present obligation to transfer future economic benefits or service potential to third parties (including the general public) when it initially gains control of an asset subject to a condition. As such the recipient is unable to avoid the outflow of resources (not complying with the conditions also has economic effects for the recipient). An example of that would be a condition that obliges the recipient to either use the funds to provide services within a certain period, or return them to the grantor.

35 If the recipient is not required to either consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties or else to return to the transferor future economic benefits or service potential, then the stipulation fails to meet the definition of a condition and would not create any performance obligations.

The conditions must be sufficiently specific

36 Government assistance to entities can be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the entity. Conversely some grants are more closely related to specific actions by the recipient, such as purchasing an asset or hiring a certain number of employees.

37 Conditions can 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.

38 There might be agreements where delivery of services may 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 if and when any performance obligations are fulfilled.

Fulfilment of the conditions must be liable to be assessed

39 Linked to the point above, the recipient should be able to assess if the condition has been fulfilled. There needs to be a minimum level of details and specification of such matters as the nature or quantity of the goods and services to be provided or the nature of assets to be acquired as appropriate and, if relevant, the periods within which performance is to occur.

40 Performance is generally monitored by, or on behalf of, the transferor on an ongoing basis. This is particularly the case when a condition a stipulation provides for a proportionate return of the equivalent value of the asset if the entity partially performs the requirements of the condition.

The realisation of the condition must within the control of the entity

41 A condition such as an event outside the control of the entity would not create performance obligations (e.g a grant repayable if global market conditions or global economy improves).

Questions for EFRAG TEG

42 Does EFRAG TEG agree with that conditions with the characteristics illustrated above are similar to performance obligations – and may be treated likewise?

Outstanding issues to the proposed approach and next steps

43 The EFRAG Secretariat acknowledges that there are still a number of issues to investigate.

44 First, the conceptual basis identified in paragraph 7 above is not applicable to all non-reciprocal transactions - for instance, it would not apply to a transaction under which a commercial entity provides financial support to another without the transferral of specific goods or services. The EFRAG Secretariat understands that there are similar cases in some industries.

45 In some cases, it might not always be straightforward to determine whether a resource provider obtains a directly identifiable asset or service from the payment (for which normal recognition requirements would apply) or if third parties obtain indirect benefits. In other cases, the transaction may include both exchange and non-exchange components.

46 The EFRAG Secretariat also notes that at this stage of the project, the focus is still on the timing and pattern of recognition of income and expenses. Given the definition in paragraph 4 above, there will be cases where the issue is rather about measurement, such as subsidized purchases or sales, where the goods or services are identifiable, but the terms are not at arm's length. The EFRAG Secretariat has not yet considered how the model would apply to these cases.

Appendix 1: Types of non-reciprocal transactions

Transaction	Revenue or cost-generating transaction	Imposed transaction	Non-reciprocal transaction	Within the scope, if 'imposed transaction' is removed
Income taxes	cost	Yes	yes	yes
Levies and other taxes	cost	Yes	yes	yes
Consumption taxes	cost	Yes	yes	yes
Property taxes	cost	yes	yes	yes
Social insurance taxes	cost	yes	yes	yes
Free emission rights	cost	yes	yes	yes
Government grants	revenue	no	yes	yes
Donations	cost/revenue	no	yes	yes
Forgivable loans and low-interest loans under IAS 20	cost/revenue	no	yes	yes
Commercial transactions with governments at market terms	cost/revenue	no	no	no
Transactions with governments as shareholders	n/a	no	no	no
Dividend distributions	n/a	no	yes	no
Capital increases	n/a	no	yes	no

Appendix 2 – Compared expense and income-generating models

47 The following graph compared the proposed approaches for expense and income generating transactions:

Expense-generating transactions		**Income-generating transactions**	
Is there an identifiable service with no payment of equal value?	▪ If Yes: Normal recognition requirement applies. ▪ Possible measurement issues (TBD)	Are there identifiable services or assets with no payment of equal value?	▪ If Yes: Normal recognition ▪ If No: move to step 2
Is there no identifiable service and the payment is transaction linked?	▪ If Yes: Recognise at the time of the underlying transaction	Is the transfer of resources subject to conditions?	▪ If No: recognise immediately ▪ If Yes move to Step 3
Is the payment not transaction linked, but recurrent	▪ If Yes: Recognise progressively over two payment dates.	Do the conditions create performance obligation(s) for the beneficiary	▪ If yes: recognise linearly over the period in which obligations are fulfilled
Is the payment not transaction linked and one/of?	▪ If Yes: Recognise as soon as unavoidable	If the conditions performance obligation(s) for the beneficiary	▪ Recognise when all conditions are satisfied.