ASB
Accounting Standards Board

EXECUTIVE SUMMARY - RESEARCH PAPER ON REVENUE FROM CONTRACTS WITH CUSTOMERS ON REVENUE IN THE PUBLIC SECTOR

Background

The suite of Standards of GRAP issued by the Accounting Standards Board (the Board) includes three revenue related standards, i.e. Standards of GRAP on *Revenue from Exchange Transactions* (GRAP 9)*, Construction Contracts* (GRAP 11)*,* and *Revenue from Non-exchange Transactions (Taxes and Transfers)*(GRAP 23)*.* These Standards are based on the equivalent International Public Sector Accounting Standard (IPSASs), which are, with the exception of the Standard on non-exchange revenue, based on the equivalent International Financial Reporting Standards (IFRSs).

The International Accounting Standards Board (IASB) recently revised the IFRSs dealing with revenue by issuing IFRS 15 *Revenue from Contracts with Customers.* The issue of IFRS 15 results in a change in the approach to recognising revenue from a risks and rewards to a control-based model. As a result, there has been a change internationally to the way in which revenue from exchange transactions is recognised. As the Standards of GRAP are based on the international equivalents, the Board initiated a project to research the potential impact of this change on the way in which revenue is recognised and measured from typical public sector transactions.

Revenue from exchange transactions in the public sector has been recognised based on a risk and rewards model. Revenue from non-exchange transactions is based on a control-based approach. Because of the change in approach to recognising exchange revenue, the Board also wanted to assess whether it is feasible to combine the revenue recognition approaches for non-exchange and exchange revenue transactions.

The detailed findings of the research are included in *Research Paper – Impact of IFRS 15 Revenue from Contracts with Customers on Revenue in the Public Sector.* A summary of the key findings is outlined below.

Summary of key findings

Revenue from exchange transactions

Taken at a high level, the concepts in IFRS 15 and the current Standards do not result in a significant difference in the timing of the revenue recognised The approaches outlining revenue recognition are however quite different.

IFRS 15 outlines the following approach to revenue recognition and measurement:

(a) The identification of a contract with a customer for the supply of goods and services in the ordinary course of business.
(b) The identification of performance obligations in the contract.
(c) The determination of the transaction price.
(d) The allocation of the transaction price to the performance obligations.
(e) The recognition of revenue when the performance obligations are satisfied.

GRAP 9 and GRAP 11 base revenue recognition on the type of transaction, i.e. whether revenue relates to the provision of goods, services, interest, royalties or dividends. Because the approach in IFRS 15 relates only to contracts with customers for goods and services supplied in the ordinary course of operations, interest and dividends are excluded from its scope. While there is a difference in scope between the current Standards and IFRS 15, it is not a substantive difference as the recognition of interest and dividends is dealt with in the relevant Standard on *Financial Instruments.*

In identifying the performance obligations associated with a contract under IFRS 15, there is a clear focus on identifying distinct goods and services. Once distinct goods and services are identified, performance obligations are associated with these goods and services based on the agreed transaction price. An entity recognises revenue when the performance obligations are settled, which according to IFRS 15, can be at a point in time or over time. Under the current Standards of GRAP, revenue is recognised for goods when the risks and rewards of ownership are transferred or when services are provided. Although the effect on revenue recognition may be similar, the process followed is quite different.

One of the key issues that remain, irrespective of whether IFRS 15 or the current Standards are applied, is the identification of goods and services in specific public sector transactions, e.g. professional fees paid to a regulator, where the regulator provides a ñlicenseò to undertake a certain activity, as well as provides certain services to members.

On the measurement of revenue, IFRS 15 requires an entity to assess the probability of not collecting the transaction price in the initial measurement of revenue. The current requirements of IGRAP 1 *Applying the Probability Test on Initial Recognition of Revenue* precludes such an assessment on initial recognition. This is a significant difference between IFRS 15 and the current requirements. It is likely to remain a difference, given the focus in IGRAP 1 on the accountability for revenue owing to the state.

IFRS 15 requires a significantly increased level of disclosure when compared to the current requirements.

Revenue from non-exchange transactions

As noted above, the objective of analysing the requirements of IFRS 15 in relation to non-exchange transactions was to assess whether it would be possible to align the accounting requirements for exchange and non-exchange transactions.

While it is possible to extract certain principles from the approach in IFRS 15 and apply them to non-exchange transactions, it is difficult to apply the model ñas isò to non-exchange transactions. This is because:

(a) non-exchange transactions often arise from statutory rather than contractual arrangements, which makes the initial step in the IFRS 15 difficult to apply; and

(b) non-exchange transactions are not executory in nature in that they do not require performance by both parties to the transaction. Under IFRS 15, the event that gives rise to the initial recognition of a transaction is usually based on one party to the arrangement having performed in terms of the arrangement. In contrast, the event that gives rise to the recognition of non-exchange transactions is often the occurrence of an event, e.g. a taxable event, or breach of a law. Because the recognition of transactions in IFRS 15 is driven by performance by parties and the satisfaction of performance obligations, the initial recognition of transactions and the recognition of revenue under IFRS 15 is unclear for many non-exchange transactions.

In addition to the nature of exchange and non-exchange transactions being different, the current requirements for the recognition of revenue under GRAP 23 and IFRS 15 are different when performance obligations do arise, e.g. when an entity receives resources and is required to use those resources in a specific way. Under GRAP 23, an entity only recognises an obligation when there is both an obligation to use the resources in a certain way or it is required to return the resources. IFRS 15 refers to performance obligations in the context of particular goods and services that need to be transferred to a third party. When performance obligations are seen satisfied under GRAP 23 and IFRS 15 also differs. IFRS 15 includes specific requirements, while GRAP 23 is silent.

Under the approach in IFRS 15, there are no specific requirements for the recognition and measurement of revenue from construction contracts. GRAP 11 currently provides guidance on the recognition and measurement of revenue from construction contracts arising from exchange and non-exchange transactions. It is unclear how revenue from non-exchange construction contracts would be accounted for, and would require explicit guidance.

The way forward

The IPSASB added a review of the revenue related-IPSASs to its work programme in March 2015. The scope of the project is similar to the research project undertaken by the Board. As the Board aligns its Standards of GRAP to international standards, the Board has agreed not to undertake any further work on this project until the IPSASB's project is more advanced.

The results of the research will be used to inform the inputs provided by the Secretariat and Board into the IPSASB's work.