GASB Invitation to Comment

January 23, 2018

Comments Due: April 27, 2018

Invitation to Comment

of the Governmental Accounting Standards Board

on major issues related to

Revenue and Expense Recognition

Project No. 4-6I

Governmental Accounting Standards Board

REVENUE AND EXPENSE RECOGNITION

Notice of Public Hearings and Request for Written Comments

PUBLIC HEARINGS

Public hearings are scheduled as follows:

- May 6, 2018, at the Marriott St. Louis Grand Hotel, 800 Washington Avenue, St. Louis, MO, beginning at 8:00 a.m. local time (in conjunction with the annual conference of the Government Finance Officers Association).
- May 18, 2018, at the Embassy Suites San Francisco Airport—Waterfront, 150 Anza Boulevard, Burlingame, CA, beginning at 8:30 a.m. local time.
- May 30, 2018, at the Financial Accounting Foundation offices, 401 Merritt 7, 5th Floor, Norwalk, CT, beginning at 8:30 a.m. local time.

Public hearings. The public hearings are being conducted primarily for interested individuals or organizations that intend to participate in person or by telephone. Details regarding participation will be provided after the GASB receives a notice of intent to participate.

Deadline for written notice of intent to participate in the public hearings: April 13, 2018, for the May 6, 2018 public hearing and April 27, 2018, for the remaining public hearings.

Basis for public hearings. The GASB has scheduled the public hearings to obtain information from interested individuals and organizations about the issues discussed in this Invitation to Comment. The hearings will be conducted by one or more members of the Board and its staff. Interested parties are encouraged to participate at the hearings and through written response.

Public hearing oral presentation requirements. Individuals or organizations that want to make an oral presentation in person or by telephone at a public hearing are required to provide, **by the deadline for notice of intent to participate (April 13, 2018, for the May 6, 2018 public hearing and April 27, 2018, for the remaining public hearings)**, a written notification of that intent. A copy of written comments addressing the issues discussed in this Invitation to Comment should be provided two weeks before the hearing. The notification and written submission should be addressed to the Director of Research and Technical Activities, Project No. 4-6I, and emailed to director@gasb.org. The notification should indicate the location of the public hearing at which the respondent would like to participate. A public hearing may be canceled if sufficient interest is not expressed by the deadline.

The GASB intends to schedule all respondents who want to make oral presentations and will notify each individual or organization of the expected time of the presentation. The time allotted to each individual or organization will be limited to about 30 minutes—10 minutes to summarize or elaborate on the written submissions, or to comment on the written submissions or presentations of others, and 20 minutes to respond to questions from those conducting the hearing.

Observers. Observers are welcome at the public hearings and are urged to submit written comments.

WRITTEN COMMENTS

Deadline for submitting written comments: April 27, 2018

Requirements for written comments: Any individual or organization that wants to provide written comments but does not intend to participate in a public hearing should provide those comments by **April 27, 2018.** Comments should be addressed to the Director of Research and Technical Activities, Project No. 4-6I, and emailed to director@gasb.org.

OTHER INFORMATION

Public files. Written comments and transcripts of the public hearings will become part of the GASB's public file. Written comments also are posted on the GASB's website. Copies of the transcripts may be obtained for a specified charge.

This Invitation to Comment may be downloaded from the GASB's website at www.gasb.org.

Final GASB publications may be ordered at www.gasb.org.

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Notice to Recipients of This Invitation to Comment

The Governmental Accounting Standards Board (GASB) is responsible for (1) establishing and improving standards of state and local governmental accounting and financial reporting to provide useful information to users of financial reports and (2) educating stakeholders—including issuers, auditors, and users of those financial reports—on how to most effectively understand and implement those standards.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, the GASB staff has prepared this Invitation to Comment to solicit comments on certain issues that will be addressed in the GASB's Revenue and Expense Recognition project. This Invitation to Comment identifies two models that could be a basis for recognizing revenue and expense transactions. The GASB invites respondents to comment on those models and other relevant issues.

An Invitation to Comment is a staff document designed to seek comments at a relatively early stage of a project before the GASB has reached a consensus view. This Invitation to Comment is a step toward a Preliminary Views and an Exposure Draft of a Statement of Governmental Accounting Standards but is *not* an Exposure Draft, nor does it present a preliminary view of the GASB.

We invite your comments on all matters in this Invitation to Comment, especially those addressed in the questions on the following pages. Respondents are requested to give their views only after reading the entire text of this Invitation to Comment. Because the GASB has not yet developed tentative views on these issues, it is important that you comment on any aspects with which you agree, as well as any with which you disagree. To facilitate our analysis of the response to this Invitation to Comment, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to the GASB and to staff members assigned to this project, and all comments are considered during the GASB's deliberations. Only after the GASB is satisfied that all alternatives have adequately been considered, and modifications have been made as considered appropriate, will the GASB vote to issue a Preliminary Views. In deciding on changes in accounting and financial reporting standards, the GASB also takes into consideration the costs of preparing and reporting the information and its benefits to users of financial statements. The GASB also will seek and consider comments on a Preliminary Views and an Exposure Draft before a final Statement is considered for issuance.

Summary

Why We Are Issuing This Invitation to Comment

This Invitation to Comment is being issued to obtain stakeholder feedback on the development of a comprehensive revenue and expense model for state and local governments. The GASB believes a comprehensive model should be developed because:

- Existing guidance for exchange revenue and expense transactions is limited, resulting in inconsistent reporting of information by governments.
- Existing guidance for nonexchange revenue and expense transactions, though generally effective, could be clarified and improved.
- Other accounting standards setters are considering or implementing a "performance obligation" approach for revenue recognition.
- A comprehensive model is expected to result in more robust, principles-based guidance for addressing a wide range of transactions that will improve comparability and provide more useful information.

Existing GASB standards provide limited guidance for exchange transactions; this limited guidance has resulted in inconsistencies in practice, as explained in Chapter 1. Some of that guidance is found in Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The existing guidance for recognizing revenue and expense for nonexchange transactions primarily is found in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, which was issued in 1998. Moreover, the GASB has not comprehensively examined its guidance related to revenue and expense recognition since the issuance of Concepts Statements No. 4, *Elements of Financial Statements*, and No. 6, *Measurement of Elements of Financial Statements*.

Other accounting standards setters are considering or implementing comprehensive, principles-based revenue recognition guidance using a performance obligation model. Furthermore, other standards setters are considering the application of performance obligation models for revenue and nonexchange expense recognition in the public sector.

Given this environment, the GASB believes that now is an appropriate time to consider developing a comprehensive revenue and expense model. Such a comprehensive model is expected to result in (1) more robust guidance to address a wider range of transactions, (2) improved comparability of revenue and expense recognition practices across various types of governments, and (3) more useful information to users of financial reports in making decisions and assessing accountability.

What Is Presented in This Document

This Invitation to Comment includes four chapters and two appendices. Chapter 1 addresses the project's scope, explains the components of a comprehensive revenue and expense model, introduces the two models that are the focus of this Invitation to Comment—the exchange/nonexchange model and the performance obligation/no performance obligation model—and discusses the considerations related to benefits and costs.

Chapter 2 describes the exchange/nonexchange model. The chapter includes definitions provided in existing standards for exchange and nonexchange transactions, as well as the existing recognition approach for nonexchange transactions in Statement 33, as amended. Chapter 2 also includes a discussion regarding a potential further expansion of the earnings recognition approach that would be applicable to exchange transactions. The chapter concludes with a question posed to stakeholders.

Chapter 3 describes the performance obligation/no performance obligation model. The chapter includes a potential definition of a performance obligation for the governmental environment, as well as a potential recognition approach that employs the performance obligation model. The chapter concludes with a question posed to stakeholders.

Chapter 4 provides an example of an alternative model that organizes these potential model components differently. The chapter concludes with two questions posed to stakeholders.

Finally, Appendix A includes illustrative examples, and Appendix B includes background information pertinent to this project.

QUESTIONS FOR READERS OF THIS INVITATION TO COMMENT

Individuals and organizations are invited to comment on all matters in this Invitation to Comment. Respondents are encouraged to respond to all questions that are relevant or of interest to them. It is not necessary to provide responses to all questions. The questions are repeated at the end of each applicable chapter for your convenience.

Chapter 2—Exchange/Nonexchange Model

The exchange/nonexchange model would classify revenue and expense transactions based on whether a transaction is considered exchange or nonexchange. If the transaction is an exchange, revenue or expense would be recognized based on an earnings recognition approach. If the transaction is a nonexchange, revenue or expense would be recognized based on the provisions of Statement 33, as amended.

2.1. Do you believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

Chapter 3—Performance Obligation/No Performance Obligation Model

The performance obligation/no performance obligation model would classify revenue and expense transactions on the basis of whether a binding agreement contains one or more performance obligations. If the transaction contains a performance obligation, revenue or expense would be recognized following the performance obligation recognition approach. If the transaction does not contain a performance obligation, revenue or expense would be based on the provisions of Statement 33, as amended.

3.1. Do you believe the performance obligation/no performance obligation model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

Chapter 4—Alternative Models

Other alternative revenue and expense recognition models could be suitable for governments.

4.1. Do you believe that the alternative model presented as an example in Chapter 4 could provide a suitable basis for classifying transactions and recognizing revenue and expense? If so, what are the potential benefits and challenges of that model?

4.2. The models distinguish transactions on the basis of (a) exchange or nonexchange or (b) a performance obligation or no performance obligation. Do you believe there is another alternative for distinguishing revenue and expense transactions? If so, please describe that alternative and explain why you believe it would be suitable.

CHAPTER 1—INTRODUCTION

Objective of the Revenue and Expense Recognition Project

1. The objective of the Revenue and Expense Recognition project is to develop a comprehensive revenue and expense model based on principles that would establish guidance that different types of governments would be able to apply to a wide range of transactions. (Refer to Appendix B for a more extensive discussion of the background of the project.) At a minimum, the project is:

a. Evaluating recognition of certain elements reported in the financial statements in the context of the GASB's conceptual framework (chiefly, revenues and expenses and, by extension, certain related assets, liabilities, deferred outflows of resources, and deferred inflows of resources)
b. Considering the introduction of a "performance obligation" approach to the GASB's authoritative literature
c. Addressing, as necessary, issues regarding existing standards as they have been applied in practice.

2. Concepts Statements No. 4, *Elements of Financial Statements*, and No. 6, *Measurement of Elements of Financial Statements*, enabled stakeholders to evaluate transactions in the context of the elements of financial reporting. The development of a principles-based revenue and expense recognition model in an authoritative pronouncement(s) would enhance the guidance regarding the classification, recognition, and measurement of revenues and expenses, thereby increasing reporting consistency and improving transparency. The expected model also would operationalize the recognition and measurement concepts.

Reasons for This Project and This Invitation to Comment

3. This Invitation to Comment is being issued to obtain stakeholder feedback on the development of a comprehensive model that state and local governments would employ when classifying, recognizing, and measuring revenue and expense transactions. The GASB believes a comprehensive model should be developed because:

a. Existing guidance for exchange revenue and expense transactions is limited, resulting in inconsistent reporting of information by governments.
b. Existing guidance for nonexchange revenue and expense transactions, though generally effective, could be clarified and improved.
c. Other accounting standards setters are considering or implementing a performance obligation approach for revenue recognition.
d. A comprehensive revenue and expense recognition model is expected to result in more robust guidance for addressing a wide range of transactions that will improve comparability and will provide more useful information.

Exchange and Nonexchange Transactions

4. Existing GASB standards provide limited guidance for exchange transactions. Some of that guidance is found in Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which is based on pronouncements issued before November 30, 1989, by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA). Other authoritative guidance for exchange expenses largely has focused on the recognition of outflows of resources for specific transactions, such as postemployment benefits, leases, and asset retirement obligations. However, there is limited *general* guidance that can be applied to other exchange expenses. Likewise, authoritative guidance for exchange revenues is limited.

5. The existing guidance for recognizing revenue and expense from nonexchange transactions is in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* which was issued in 1998. Statement 33 was amended in 2000 by Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenue.* Those Statements were the subject of a post-implementation review by the Financial Accounting Foundation in 2015. That review found that, although the guidance generally was effective in achieving its stated objectives, some practice challenges existed in classifying and recognizing nonexchange transactions. For example, a local government may participate in a program in which it receives resources in installments from a state government for a specified purpose. The program may require documentation of the activities for which the resources are used and a final report to the state government. In applying Statement 33, as amended, some local governments may classify such a program as a reimbursement-driven grant, while others may classify it as a purpose-restricted grant. Other governments may emphasize the obligation to provide a final report, conclude it is an exchange transaction, and not apply Statement 33, as amended. Those different treatments would result in three different recognition outcomes.

6. The subjectivity of the assessment of *value* that is fundamental to the definitions of exchange and nonexchange transactions sometimes makes it challenging to distinguish between them. Classifying a revenue or expense transaction as exchange may be a matter of degree; that is, to what extent is the value exchanged equal? Those ambiguities are, in part, the underlying causes for the inconsistencies noted in practice. Moreover, the GASB's pre-agenda research indicated that preparers may report the same type of revenue at different points in time. For example, some governments recognize revenue when the government sells a service, whereas other governments recognize the same type of revenue when or as they fulfill the obligation to provide the service. The limited existing guidance for exchange revenue and expense transactions contributes to that diversity in practice.

Recent Revenue Guidance of Other Standards Setters

7. Other accounting standards setters are considering or implementing principles-based revenue recognition guidance using a performance obligation approach. The application of that guidance is intended to report decision-useful information to users of financial statements about the nature, timing, and collectability of revenues from contracts with customers. Furthermore, some of those other standards setters are considering the application of performance obligation models for revenue recognition and nonexchange expense recognition in the public sector. The recent

development of the performance obligation approach provides an opportunity to consider this new approach in the context of the governmental environment in the United States.

Development of a Comprehensive Revenue and Expense Model

8. The GASB believes that now is the appropriate time to consider developing a comprehensive revenue and expense model for several reasons: the limited existing guidance for exchange transactions, the development of revenue recognition models by other standards setters, and the challenges identified above. One alternative for developing a comprehensive model described in this Invitation to Comment would be to clarify and expand the existing exchange and nonexchange transaction guidance. Another alternative for developing a comprehensive model described in this Invitation to Comment would be to base revenue and expense classification on the existence of performance obligations and recognition on the extent to which performance obligations are fulfilled. Regardless of the alternative chosen, the goal of this project is to develop a comprehensive revenue and expense recognition model that would result in (a) more robust guidance to address a wider range of transactions, (b) improved comparability of revenue and expense recognition practices across various types of governments, and (c) more useful information to users of financial reports in making decisions and assessing accountability.

Project Scope

9. At this early stage, the project scope is relatively broad. Consequently, it is simplest to describe the project's scope in terms of what it does *not* include. Topics not included in the project's scope can be classified into three categories:

a. Topics for which guidance was established during or after the development of Concepts Statements 4 and 6—such as standards on pensions and other postemployment benefits—are excluded from the scope of this project because they were developed subsequent to the issuance of Concepts Statements addressing elements of financial reporting and measurement. For this reason, pronouncements issued after Statement No. 65, *Items Previously Reported as Assets and Liabilities,* are not included in the scope of this project.
b. Topics related to capital assets and certain liabilities—such as capital asset impairments, pollution remediation liabilities, and asset retirement obligations—are excluded because transactions involving those types of items require specialized guidance.
c. Topics related to financial instruments—such as investments, derivative instruments, leases, and insurance—are excluded because transactions involving those types of items also require specialized guidance.

When subsequently developing recognition and measurement proposals, this project will consider any conclusions reached in the Financial Reporting Model project regarding the measurement focus and basis of accounting for governmental funds. For this reason, only the economic resources measurement focus and accrual basis of accounting has been applied to the examples illustrated in this Invitation to Comment.

10. Except for the three categories of exclusions, other revenue and expense transactions are included in the scope of this project. Adjustments to the scope of the project may occur as the project progresses.

Components of a Comprehensive Model

11. As noted earlier, a comprehensive revenue and expense model would include the following three components: classification, recognition, and measurement.

a. *Classification* is the process of identifying a type of transaction by applying conceptual definitions. For example, based on existing standards, sales tax revenue is classified as a nonexchange revenue transaction.

b. *Recognition* is the process of determining when[1] an item should be reported as an element (such as an asset or an inflow of resources) in financial statements. For example, existing guidance provides that an asset from a sales tax transaction should be recognized when the exchange transaction from which the tax is derived occurs or when the resources are received, whichever is first. Sales tax revenue (an inflow of resources) should be recognized in the same period that the asset is recognized, provided that the underlying exchange transaction has occurred.

c. *Measurement* is the process of determining a value for the elements presented in financial statements. For example, an asset (sales taxes receivable) arising from a sales tax revenue transaction could be measured using the settlement amount measurement attribute.

12. For this Invitation to Comment, the model components described in paragraph 11 are organized as follows:

	Exchange/Nonexchange Model	**Performance Obligation/No Performance Obligation Model**
Classification	Is the transaction an exchange?	Does the transaction contain a performance obligation?
Recognition	***Exchange Transaction*** Recognize based on earnings recognition approach	***Transaction contains performance obligation(s)*** Recognize based on performance obligation recognition approach
	Nonexchange Transaction Recognize based on Statement 33 provisions	***Transaction does not contain a performance obligation*** Recognize based on Statement 33 provisions
Measurement	*Measurement is not addressed in this Invitation to Comment but will be addressed in a later due process document.*	

[1]Based on a tentative decision reached during redeliberations of the Preliminary Views, *Recognition of Elements of Financial Statements and Measurement Approaches,* recognition is the determination of when an element should be reported in financial statements. That determination would be made by considering when (a) an item meets the definition of an element as defined in Concepts Statement 4 and (b) the measurement of the item sufficiently reflects the qualitative characteristics described in Concepts Statement No. 1, *Objectives of Financial Reporting.*

13. These models have been developed only at a basic-principles level. Additional stakeholder feedback is needed to develop guidance for how to apply those principles in practice. At this point in the project, the GASB has not decided—even tentatively—whether to propose changes or additions to existing guidance, or which model, if any, would be proposed in a future due process document. Issuing an Invitation to Comment allows the solicitation of views from stakeholders before the GASB considers developing a detailed proposal.

Considerations Related to Benefits and Costs

14. One of the principles guiding the GASB's setting of standards for accounting and financial reporting is the assessment of expected benefits and perceived costs. The GASB strives to determine that its standards address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared with the expected overall public benefit. The potential benefits of these models are highlighted throughout this Invitation to Comment. At this point, the GASB has not fully assessed the potential costs of implementing the models. One purpose of this Invitation to Comment is to obtain additional input on the challenges (which could equate to costs) and benefits associated with the alternatives.

This Invitation to Comment

15. An Invitation to Comment is a GASB staff document that is issued in the early stages of a project, before the GASB members have reached tentative agreement on how to address the issues raised in the project. As such, this is a key opportunity for stakeholders to influence the direction of the GASB's deliberations on the fundamental issues being considered. It is important for stakeholders to include in their feedback answers to the questions posed in this document. The questions can be found on page viii and also are presented at the end of Chapters 2, 3, and 4.

16. There are three additional chapters in this Invitation to Comment and two appendices:

a. Chapter 2 describes the exchange/nonexchange model. The chapter includes definitions provided in existing standards for exchange and nonexchange transactions, as well as the existing recognition approach for nonexchange transactions in Statement 33, as amended. Chapter 2 also includes a discussion regarding a potential further expansion of the earnings recognition approach that would be applicable to exchange transactions. The chapter concludes with a question posed to stakeholders.
b. Chapter 3 describes the performance obligation/no performance obligation model. The chapter includes a potential definition of a performance obligation for the governmental environment, as well as a potential recognition approach that employs the performance obligation model. The chapter concludes with a question posed to stakeholders.
c. Chapter 4 provides an example of an alternative model that organizes these potential model components differently. The chapter concludes with two questions posed to stakeholders.
d. Appendix A includes illustrative examples, and Appendix B includes the project background.

CHAPTER 2—THE EXCHANGE/NONEXCHANGE MODEL

Overview

1. The GASB's pre-agenda research indicated that some practitioners have encountered difficulties distinguishing between exchange and nonexchange transactions. One approach to addressing those difficulties would be to enhance existing exchange and nonexchange authoritative guidance by developing a comprehensive model that would apply to a broad range of transactions. The basis of the exchange/nonexchange model includes guidance that currently exists in the GASB authoritative literature; therefore, the model would be familiar to stakeholders. However, this model expands on several concepts and highlights potential modifications that would be needed to further develop current literature into a complete model for revenue and expense recognition. For example, the exchange/nonexchange model requires classification based on existing concepts of exchange and nonexchange; however, as noted later in this chapter, additional guidance could be provided related to the term *equal value*.

2. In this model, the classification of transactions would be based on whether the revenue or expense is an exchange or a nonexchange transaction. If the transaction is classified as exchange, revenue or expense would be recognized based on an earnings recognition approach. If the transaction is classified as nonexchange, revenue or expense would be recognized according to the provisions of Statement 33, as amended.

Exchange/Nonexchange Model		
Classification	Is the transaction an exchange?	
	Yes	**No**
	Exchange Transaction	***Nonexchange Transaction***
Recognition	Recognize based on the earnings recognition approach: • Government controls a resource, or incurs an obligation to sacrifice a resource, ***and*** • The change in net assets is not applicable to a future reporting period	Recognize based on Statement 33 provisions for: • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions
Measurement	*Measurement is not addressed in this Invitation to Comment but is expected to be addressed in a later due process document.*	

Classification

3. The first process in this model is classifying whether a transaction is an exchange or a nonexchange transaction. The GASB established the definitions for exchange and nonexchange transactions in Statement 33, as amended:

a. Exchange transactions are those in which each party receives and gives up essentially equal values.[2]
b. Nonexchange transactions are those in which a government gives or receives value without directly receiving or giving equal value in exchange.

4. Although the notion of value is integral to the classification of transactions in the exchange/nonexchange model, the amount of value given and received by each party in a transaction may be difficult to determine. The value of what has been given or received could be based on cost but also may include many types of subjective characteristics that are unique to each party to the transaction. Further, the determination of whether the values given or received in the transaction are essentially equal, related but not quite equal, or unequal varies depending on the situation or the assessment by the government. If the GASB chooses to pursue the exchange/nonexchange model in this project, further development of the notion of value may need to be considered.

5. An example of an exchange revenue transaction is the provision of electricity by a government utility. The government incurs a variety of costs: the construction and maintenance of its electrical system, the generation and distribution of power, administration, and so on. It charges its customers an amount to cover those costs. The government and customer are exchanging what the government considers to be essentially equal values in the transaction.

6. Many common expense transactions that governments engage in are exchanges. For example, the payment of wages by a government for services rendered by its employees is an exchange transaction. That conclusion is based on the view that the amount of wages paid is what the government considers to be essentially equal to the value of the services provided by its employees.

7. An example of a nonexchange revenue transaction is a local government levying a tax on property owners based on the assessed value of their property. The proceeds of the tax may be used for various purposes such as to provide public safety or transportation services to the citizens of the government, but a property owner paying the tax generally does not receive those public services in levels equal to the amount of tax they paid. It is possible that they may never use some of the services financed by the tax at all.

[2] Statement 33 also defines *exchange-like transactions.* As discussed in this document, the determination of whether a transaction is exchange, exchange-like, or nonexchange can present challenges. In order to simplify the discussion of the exchange/nonexchange model in this document, transactions that do not meet the definition of nonexchange transactions are assumed to be exchange transactions.

8. Governments also incur expenses as a result of nonexchange transactions. For example, many government grants provide value to the recipient without the provider receiving equal value in return.

Recognition

9. After a transaction has been classified as either exchange or nonexchange, a government would apply the particular recognition approach that the model defines for each classification:

a. For exchange transactions, revenue and expense would be recognized following the earnings recognition approach.
b. For nonexchange transactions, revenue and expense would be recognized following the provisions of Statement 33, as amended.

The Earnings Recognition Approach

10. Similar to existing literature, the guiding principle for the recognition of exchange revenue and expense is that transactions should be recognized when an exchange is complete. This concept of revenue and expense recognition will be referred to in this Invitation to Comment as the *earnings recognition approach*. Recognition can be at a point in time (or over time) when the revenue has been earned by the provider of the good or service or when the recipient is obligated to pay for the good or service received. Determining when an exchange is complete may depend on specific facts and circumstances. For example, existing literature provides for recognition based on percentage of completion or installment accounting.

Revenues

11. Exchange revenues for governments involve providing goods or services to an individual, an entity (including another government), a group of individuals, or a group of entities. Revenue is considered to have been earned when a government has substantially accomplished what it is required to do to be entitled to the net assets represented by the revenue. Based on this approach, a government would recognize exchange revenue if both of the following criteria are met:

a. The government is controlling a resource (an asset, for example, cash or claims to cash).
b. The increase in net assets resulting from the transaction is not applicable to a future reporting period.

Consequently, if the government does not control a resource, no revenue would be recognized. Furthermore, if the government controls a resource and recognizes an asset but the increase in net assets is applicable to a future reporting period, the government would recognize a deferred inflow of resources.

Expenses

12. A government incurs an exchange expense if it has received, and is obligated to sacrifice resources for, goods or services provided by an individual, an entity (including another government), a group of individuals, or a group of entities. An expense is considered to have been

incurred when the government has consumed net assets. Based on this approach, a government would recognize an exchange expense if both of the following criteria are met:

a. The government has incurred an obligation to sacrifice resources (a liability) that the government has little or no discretion to avoid.
b. The consumption of net assets resulting from the transaction is not applicable to a future reporting period.

Consequently, if the government has not incurred a liability, no expense would be recognized. Furthermore, if the government has incurred a liability but the consumption of net assets is applicable to a future reporting period, the government would recognize a deferred outflow of resources.

The Provisions of Statement 33

13. The recognition in this model related to nonexchange transactions is consistent with the recognition provisions for each type of nonexchange transaction described in Statement 33, as amended. The exchange/nonexchange model in this Invitation to Comment does not propose modifications to that guidance.

14. Applying the provisions of Statement 33, as amended, to nonexchange revenue and expense transactions includes further classification into one of four types of nonexchange transactions, based upon their characteristics:

a. *Derived tax revenues* result from assessments imposed by governments on exchange transactions (for example, income taxes and sales taxes).
b. *Imposed nonexchange revenues* result from assessments by governments on nongovernmental entities, including individuals, other than assessments on exchange transactions (for example, property taxes and fines).
c. *Government-mandated nonexchange revenues and expenses* result from a government (including the federal government) at one level providing resources to a government at another level and requiring that government to use them for a specific purpose or purposes established in the provider's enabling legislation (for example, federal grants for programs that local governments are required to perform).
d. *Voluntary nonexchange revenues and expenses* result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties (for example, many grants and entitlements).

15. Paragraphs 16–20 of Statement 33, as amended, provide the following guidance for these types of transactions:

> ### *Derived Tax Revenue Transactions*
>
> 16. Governments should recognize *assets* from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. *Revenues* should be recognized, net of estimated refunds and estimated

uncollectible amounts, in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred. Resources received in advance should be reported as liabilities until the period of the exchange. Derived tax revenues generally do not have time requirements. However, if they apply, asset and revenue recognition should be consistent with the requirements for imposed nonexchange revenue transactions.

Imposed Nonexchange Revenue Transactions

17. Governments should recognize *assets* from imposed nonexchange revenue transactions in the period when an enforceable legal claim to the assets arises or when the resources are received, whichever occurs first. For property (ad valorem) taxes, the date when an enforceable legal claim to taxable property arises generally is specified in the enabling legislation. Many governments refer to this date as the "lien date," even though a lien is not formally placed on the property at that date. Some governments, however, use a different term, such as the "assessment date." (For some governments, the enforceable legal claim does not arise until the period after the period for which the taxes are levied. Those governments should recognize property taxes receivable in the same period that revenues are recognized in accordance with paragraph 18.)

18. Governments should recognize *revenues* from property taxes, net of estimated refunds and estimated uncollectible amounts, *in the period for which the taxes are levied,* even if the enforceable legal claim arises or the due date for payment occurs in a different period. All other imposed nonexchange revenues should be recognized in the same period that the assets are recognized unless the enabling legislation includes time requirements. If so, revenues should be recognized in the period when the resources are required to be used or when use is first permitted. Deferred inflows of resources associated with imposed nonexchange revenue transactions should be reported when resources are received or reported as a receivable before (a) the period for which property taxes are levied or (b) the period when resources are either required to be used or when use is first permitted for all other imposed nonexchange revenues in which the enabling legislation includes time requirements.

Government-Mandated and Voluntary Nonexchange Transactions

19. Providers of resources in government-mandated or voluntary nonexchange transactions frequently establish eligibility requirements. Eligibility requirements are conditions established by enabling legislation or the provider that are required to be met before a transaction (other than the provision of cash or other assets in advance) can occur. That is, until those requirements are met, the provider generally does not have a liability, the recipient generally does not have a receivable, and expenses and revenues for resources transmitted in advance should not be recognized until those eligibility requirements are met.

Eligibility Requirements

20. Eligibility requirements for government-mandated and voluntary nonexchange transactions comprise one or more of the following:

a. *Required characteristics of recipients.* The recipient (and secondary recipients, if applicable) has the characteristics specified by the provider. (For example, under a certain federal program, recipients are required to be states and secondary recipients are required to be school districts.)
b. *Time requirements.* Time requirements specified by enabling legislation or the provider have been met. (The period when the resources are required to be used [sold, disbursed, or consumed] or when use is first permitted has begun, or the resources are being maintained intact, as specified by the provider.)
c. *Reimbursements.* The provider offers resources on a reimbursement ("expenditure-driven") basis and the recipient has incurred allowable costs under the applicable program.
d. *Contingencies* (applies only to voluntary nonexchange transactions). The provider's offer of resources is contingent upon a specified action of the recipient and that action has occurred. (For example, the recipient is required to raise a specific amount of resources from third parties or to dedicate its own resources for a specified purpose and has complied with those requirements.)

Application Issues

16. The discussion of the exchange/nonexchange model for revenue and expense in this document is conceptual in nature. If the GASB determines that the exchange/nonexchange model would provide a better basis for revenue and expense classification, recognition, and measurement, there are several application issues related to existing guidance that may require further consideration and development. Application issues that could be addressed in a later stage of this project include:

a. *Classification*—As previously noted, a challenge that has been identified with the exchange/nonexchange model is the subjectivity associated with the notion of value, which is integral to classifying transactions as exchange or nonexchange. A clarification of the basis for classifying revenue and expense transactions as exchange, exchange-like, or nonexchange may be needed.
b. *Recognition*—This Invitation to Comment is limited to the recognition of revenue and expense transactions for the economic resources measurement focus. Recognition of transactions for a financial resources measurement focus may need to be addressed.[3]

[3]Recognition proposals applicable to governmental funds would be based on the conclusions that the Board reaches in the Financial Reporting Model project.

c. *Measurement*—Although this Invitation to Comment does not discuss measurement guidance, specific measurement issues may need to be considered.

Potential Benefits and Challenges of the Exchange/Nonexchange Model

17. The main benefit of this project, regardless of the model selected for development, would be to produce a comprehensive principles-based model to address classification, recognition, and measurement of revenue and expenses. The development of any model would involve overcoming challenges. Paragraphs 21 and 22 list specific potential benefits and challenges related to the exchange/nonexchange model. Some aspects of the model may be viewed as benefits by some stakeholders and challenges by others.

Potential Benefits

18. Potential benefits of the exchange/nonexchange model:

a. It is intended to provide a principles-based model to address revenue and expense recognition. One of the challenges identified in the GASB's pre-agenda research was that existing guidance applicable to revenue and expense is disparate and can produce inconsistencies in practice. Statement 33, as amended, provides guidance for nonexchange transactions. Moreover, guidance for exchange transactions is limited, and that guidance is presented in multiple pronouncements. Consequently, a single principles-based model for revenue and expense recognition is expected to result in increased consistency and comparability in financial reporting.
b. It is intended to provide a conceptually consistent approach to addressing revenue and expense transactions. The GASB has not comprehensively examined its guidance related to revenue and expense recognition since the issuance of Concepts Statements 4 and 6. Any further development of the exchange/nonexchange model would take those concepts into consideration.
c. It would retain the existing classification of revenue and expense as either an exchange or a nonexchange transaction. Stakeholders are familiar with the terminology of this model.

Potential Challenges

19. Potential challenges of the exchange/nonexchange model:

a. It would retain a classification approach that includes exchange and nonexchange transactions. Pre-agenda research performed by the GASB determined that the distinctions between those classifications may not be clear in practice, which may result in inconsistencies in the accounting for, and financial reporting of, some revenues and expenses.
b. It would continue to require the determination of when eligibility requirements for certain nonexchange transactions have been met, which has proven to be challenging to some governments in practice.

c. It may require significant additional application guidance in order to achieve consistency in practice for exchange transactions. Due to the other challenges identified, the development of the exchange/nonexchange model likely would necessitate considerable implementation guidance.

Question
2.1. Do you believe the exchange/nonexchange model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

CHAPTER 3—THE PERFORMANCE OBLIGATION/NO PERFORMANCE OBLIGATION MODEL

Overview

1. The GASB's pre-agenda research indicated that some practitioners have encountered difficulties distinguishing between exchange and nonexchange transactions. A potential solution to this challenge could be to base the classification process on a different concept—a performance obligation.

2. In this model, the classification of transactions would be based on whether they contain a performance obligation in a binding arrangement. The potential definition of performance obligation is presented in paragraph 3. If a transaction contains a performance obligation, revenue or expense would be recognized based on the performance obligation recognition approach (described in paragraphs 14–21). If the transaction does not contain a performance obligation, revenue or expense would be recognized according to the provisions of Statement 33, as amended.

Performance Obligation/No Performance Obligation Model

Classification	Does the transaction contain a performance obligation in a binding arrangement?	
	Yes	**No**
	Performance Obligation	***No Performance Obligation***
Recognition	Recognize based on performance obligation recognition approach: • Determine consideration • Allocate consideration to performance obligation(s) • Recognize revenue or expense as each performance obligation is satisfied (at a point in time or over time) and the transaction is applicable to the reporting period(s)	Recognize based on Statement 33 provisions for: • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions
Measurement	*Measurement is not addressed in this Invitation to Comment but is expected to be addressed in a later due process document.*	

Classification

3. Determining whether a transaction contains a performance obligation in a binding arrangement could be based on the following definition:

A performance obligation is a promise in a *binding arrangement* between a government and *another party* to provide *distinct goods or services* to a *specific beneficiary*.

a. A *binding arrangement* represents a legally enforceable mutual understanding between two or more parties regarding their identifiable rights and obligations. Those rights and obligations would articulate in equivalent terms.
b. *Another party* is any legally separate entity or person that takes part in a transaction with a government, such as a customer, resource provider, vendor, or employee.
c. *Distinct goods or services* are separately identifiable and can provide benefits on their own. Distinct goods or services also can be bundled or provided in a series.
d. A *specific beneficiary* is the party that receives the benefit of the goods or services provided and with characteristics that can be identified and distinguished from the general public. A specific beneficiary can be an individual, entity, group of individuals, group of entities, or the government.

Binding Arrangement

4. For purposes of this model, the term *binding arrangement* is intended to encompass a broad spectrum of formal and informal arrangements. Examples of formal arrangements include contracts, grant agreements, memorandums of understanding, and enabling legislation. The term would encompass less formal arrangements as well, such as the creation of a new customer account for water and sewer service with a public utility or the issuance of a legally enforceable purchase order. Regardless of the level of formality in the arrangement, it would be necessary that the binding arrangement be legally enforceable; that is, an arrangement that has standing in a court of law and can be enforced through legal procedures.

5. In the context of this model, a binding arrangement includes identifiable rights and obligations of the parties that *articulate in equivalent terms.* In other words, the amount of consideration received or provided in the transaction corresponds to the amount of goods or services provided or received. For example, an individual purchases tickets to a public university sporting event. The amount of revenue that the university receives is based on the number of tickets sold. Therefore, the rights and obligations of the parties would articulate in equivalent terms. Conversely, an example of rights and obligations that do not articulate in equivalent terms is a government that taxes the purchase of gasoline (revenue) for the purpose of road maintenance (service). This arrangement does not articulate in equivalent terms because the bases for the consideration received and the services provided are different. The gas tax charged to the purchaser is based on an amount of cents per gallon, whereas the service of road maintenance is based on a different measure, such as miles of road resurfaced or potholes filled. In this example, the revenue that the government receives is based on the amount of gasoline sold in the jurisdiction and not the level of service provided. If the rights and obligations in a binding arrangement do not articulate in equivalent terms, those rights and obligations would not meet the definition of a performance obligation as described in this model.

Another Party

6. The term *another party* in a binding arrangement refers to the counterparty (or counterparties) of the agreement from whom the government has obtained rights or assumed

responsibilities. Often, the other party also is the specific beneficiary receiving the goods or services in the binding arrangement. For example, in a revenue transaction in which a government receives payments for providing water to a rate payer, the other party in the arrangement also would be the specific beneficiary.

7. The other party, however, may not always be the specific beneficiary of the goods or services in the arrangement. For example, in a revenue transaction, a local government enters into a grant agreement with a state government to provide services to a specific group of individuals. The other party would be the state government, but the specific beneficiary would be the specific group of individuals. The distinction between the other party to a transaction and the specific beneficiary of the transaction is important because in the government environment, the performance obligation approach could be applicable to transactions that are currently classified as nonexchange, such as the grant transaction just described. Issues related to specific beneficiaries are discussed further in paragraphs 11 and 12.

Distinct Goods or Services

8. The term *distinct goods or services* refers to goods or services that have the ability to benefit a recipient individually or in combination with resources controlled at present by the recipient and to whether those goods or services can be separately identified in the arrangement. Distinct goods or services would be evaluated from the beneficiary's perspective. For example, a summer soccer camp for children provided by a township's parks and recreation department would be a distinct service because the summer camp can benefit the children individually and the service can be specifically identified.

9. There are situations in which the goods or services are not separately identifiable or do not provide benefit on their own. In those cases, a government would consider whether there is a bundle of goods or services that becomes separately identifiable and provides benefit on its own. For example, bundled services could be building code enforcement for which a government charges a fee. The activities involved in the transaction include a building inspection and the issuance of a building permit. Neither of the services individually—the inspection or issuance of the permit—would benefit the developer. Therefore, there is a need to combine both activities to conclude that the service bundle (the inspection and the issuance of the permit) is distinct and that the service is specifically identified.

10. A series of distinct goods or services are those that are substantially the same and have the same pattern of transfer. Examples of distinct goods or services transferred in a series include water provision, electric transmission, and cable television service.

Specific Beneficiary

11. The specific beneficiary of a binding arrangement is the party that receives the distinct goods or services. The specific beneficiary should be identified and distinguished from the general public. For expense transactions, the specific beneficiary of the goods or services promised in the arrangement is the government. For revenue transactions, the specific beneficiary of the goods or services provided by a government would need to be specific enough to be distinguished from the general public.

12. The specificity of the beneficiary applies to individuals or groups. In other words, the characteristics of the individual or group would need to be sufficiently precise to identify them separately from the government's citizenry in general. Examples of a specific beneficiary include a government identified by its own name and a person identified by his or her legal name. Examples of a specific group of beneficiaries include low-to-moderate-income citizens in need of affordable housing that are eligible for participation in Community Development Block Grant programs. An example of a group of beneficiaries that is not specific is persons in need of public safety services supported by property taxes. That group would not be sufficiently distinguishable from the general public; consequently, the transaction (payment and receipt of property taxes) would not be classified as containing a performance obligation.

Classifying the Transaction

13. This classification process is different from existing guidance that distinguishes between exchange and nonexchange transactions. In this model, a government would need to apply the definition of a performance obligation to determine how to classify a transaction. If a government is unable to identify a promise in a binding arrangement with rights and obligations that articulate in equivalent terms, a specific beneficiary, or distinct goods and services, the transaction would be classified as not containing a performance obligation. Because this classification process would be new, additional guidance may be needed to operationalize the classification process.

Recognition

14. After a government has determined whether a transaction contains a performance obligation, it would apply the corresponding recognition approach:

a. For transactions identified as containing a performance obligation, revenue and expense would be recognized following the performance obligation recognition approach described in paragraphs 16–21 of this chapter.
b. For transactions identified as *not* containing a performance obligation, revenue and expense would be recognized following Statement 33, as amended, as described in paragraphs 13–18 of Chapter 2.

15. The guiding principle of the performance obligation recognition approach is that governments would recognize:

a. Revenue in a transaction when there is a transfer of goods or services to a specific beneficiary for consideration that the government expects to receive[4]
b. Expense in a transaction when there is a receipt of goods or services from another party in return for consideration that the government has committed to pay.

16. The recognition process would involve the following three steps:

a. Determine the amount of consideration that a government expects to receive or commits to pay pursuant to the binding arrangement.

[4]Although the topic of measurement has not been discussed in this Invitation to Comment, determining consideration as an expected amount versus a stipulated amount may be further developed in a later stage of this project.

b. Allocate the consideration to each performance obligation identified in the binding arrangement.
c. Recognize revenue or expense as the performance obligations are satisfied at a point in time or over time; and the transaction is applicable to the reporting period(s).

17. *Consideration* would represent the total amount that a government has committed to pay or expects to receive for the goods or services specified in the binding arrangement. Consideration can be a fixed or variable amount and could include noncash items.

18. If there is only one performance obligation:

a. Revenue would equal the amount of consideration the government expects to receive for the transaction.
b. Expense would equal the amount of the government's obligation to sacrifice resources in the transaction.

However, if a binding arrangement contains multiple performance obligations, a government would allocate a portion of the amount of consideration to each of the performance obligations identified.

19. As previously noted, the *recognition* of revenues or expenses when performance obligations are satisfied would require determining whether the performance obligation is satisfied at a point in time or over time.

20. Recognition of a transaction for which a performance obligation is satisfied at a point in time would require that the other party obtain control over a resource (the good or service provided). For example, a vendor has satisfied its performance obligation to a government when it delivers to the government the supplies that the government has committed to purchase. In that case, the government would recognize an expense at a point in time when it takes possession of the supplies, provided that the supplies are not recognized as inventory.

21. Alternatively, a performance obligation could be satisfied over time. For instance, if a government acts as a construction contractor for another government, the contractor government creates or enhances an asset that the beneficiary government controls. In that situation, the contractor government would recognize revenue over time, as it progressively creates or enhances the asset that the beneficiary government controls.

Application Issues

22. As previously noted, the discussion of the performance obligation/no performance obligation model for revenue and expense in this document is conceptual in nature. Consequently, this document describes in broad terms how a performance obligation/no performance obligation model could be operationalized for governments. If the GASB determines that the performance obligation/no performance obligation model would provide a better basis for revenue and expense classification, recognition, and measurement, there are several application issues that may require further consideration and development. Application issues that could be addressed in a later stage of this project include:

a. *Classification*—In order to classify transactions based on the existence of a performance obligation, several concepts in the definition of a performance obligation may need to be more fully developed, including binding arrangements, specific beneficiaries, and distinct goods or services. Specific issues regarding binding arrangements, for example, would include terms, approvals of the parties, combinations of arrangements, and terminations.

b. *Recognition*—If a performance obligation recognition approach is included in a subsequent due process document, concepts regarding the basis for allocating consideration may need to be considered, as well as whether recognition is over time or at a point in time. Additional issues regarding recognition of goods or services provided in a series also would be considered further. This Invitation to Comment is limited to recognition of revenue and expense transactions using the economic resources measurement focus. Recognition of transactions for a financial resources measurement focus approach also may need to be addressed.[5]

c. *Measurement*—Although this Invitation to Comment does not discuss measurement guidance, specific measurement issues may need to be considered.

Potential Benefits and Challenges of the Performance Obligation/No Performance Obligation Model

23. The main benefit of this project, regardless of the model selected for development, would be to produce a comprehensive principles-based model to address classification, recognition, and measurement of revenue and expense. The development of any model would involve overcoming challenges. Paragraphs 24 and 25 list specific potential benefits and challenges related to the performance obligation/no performance obligation model. Some aspects of the model may be viewed as benefits by some stakeholders and challenges by others.

Potential Benefits

24. Potential benefits of the performance obligation/no performance obligation model:

a. It is intended to provide a principles-based model to address revenue and expense recognition. One of the challenges identified in the GASB's pre-agenda research was that existing guidance applicable to revenue and expense is disparate and can produce inconsistency in practice. Statement 33, as amended, provides guidance for nonexchange transactions. Moreover, guidance for exchange transactions is limited, and that guidance is presented in multiple pronouncements. Consequently, a single principles-based model for revenue and expense recognition is expected to result in increased consistency and comparability in financial reporting.

b. It is intended to provide a conceptually consistent approach to addressing revenue and expense transactions. The GASB has not comprehensively examined its guidance related to revenue and expense recognition since the issuance of Concepts Statements 4 and 6. Any further development of the performance obligation/no performance obligation model would take those concepts into consideration.

c. It is intended to simplify the manner of classifying transactions by focusing on the existence or absence of a performance obligation. As discussed earlier, one of the challenges of the

[5]See footnote 3.

exchange/nonexchange classification is that assessing whether a government receives or provides equal value in a transaction is a matter of degree. The classification process in this model has only two possible outcomes: there is a performance obligation or there is not a performance obligation.

d. It is intended to enhance the comparability of revenue and expense information across governments by establishing a less ambiguous recognition point; that is, when a performance obligation is satisfied.

e. It would retain existing recognition guidance for transactions that do not contain a performance obligation. For example, the performance obligation/no performance obligation model would retain the provisions of Statement 33 for imposed nonexchange revenues and derived tax revenues.

Potential Challenges

25. Potential challenges of the performance obligation/no performance obligation model:

a. It would introduce a new concept—a performance obligation. Although the idea of simplifying the classification of transactions is appealing, it would come with challenges of its own. Identifying whether a performance obligation exists or has been satisfied could prove challenging in certain transactions. The concepts necessary to determine whether a transaction contains a performance obligation would be new in the government environment, and it would take time and effort to become acquainted with the new concepts. For example, it could be difficult to determine whether a good or service is distinct, or whether the beneficiaries are specific.

b. It may require significant additional application guidance in order to achieve consistency in practice. At the conclusion of this project's due process, a final pronouncement could be issued that provides principles-based guidance for classification, recognition, and measurement of revenues and expenses. However, additional application and implementation guidance likely would be necessary to ensure consistent implementation of those principles.

c. It would continue to require the determination of when eligibility requirements for certain transactions have been met, which has proven to be challenging to some governments in practice.

Question

3.1. Do you believe the performance obligation/no performance obligation model would provide a suitable basis for classifying transactions and recognizing revenue and expense? Why or why not?

CHAPTER 4—ALTERNATIVE MODELS

1. The two models described in the preceding chapters are not the only revenue and expense recognition models that could be developed using the three components (classification, recognition, and measurement) described in Chapter 1. In later stages of this project, the GASB may explore alternative models that are suggested in response to this Invitation to Comment. The purpose of considering multiple models is to determine which would be the most suitable approach for governments. An expected benefit of any model should be to minimize diversity in practice, thereby enhancing comparability, consistency, and usefulness. To that end, the GASB will consider recommendations for alternative models or improvements to the models presented that can reduce ambiguity in the classification of transactions and improve guidance for the recognition of revenues and expenses.

2. For example, an alternative model could retain the exchange/nonexchange classification of revenue and expense transactions while replacing the recognition approach for revenues or expenses classified as exchanges. That recognition approach could be changed from the earnings recognition approach to the performance obligation recognition approach. In that alternative model, the transactions classified as nonexchange would be recognized according to the requirements of Statement 33, as amended.

An Alternative Model

Classification	Is the transaction an exchange?	
Recognition	**Yes** ***Exchange Transaction*** Recognize based on performance obligation recognition approach: • Identify a performance obligation in a binding arrangement • Determine consideration • Allocate consideration to performance obligation(s) • Recognize revenue or expense as each performance obligation is satisfied (at a point in time or over time) and the transaction is applicable to the reporting period(s)	**No** ***Nonexchange Transaction*** Recognize based on Statement 33 provisions for: • Derived tax revenues • Imposed nonexchange revenues • Government-mandated nonexchange transactions • Voluntary nonexchange transactions
Measurement	*Measurement is not addressed in this Invitation to Comment but is expected to be addressed in a later due process document.*	

Questions

4.1. Do you believe that the alternative model considered as an example in this chapter could provide a suitable basis for classifying transactions and recognizing revenue and expense? If so, what are the potential benefits and challenges of that model?

4.2. The models distinguish transactions on the basis of (a) an exchange or a nonexchange or (b) a performance obligation or no performance obligation. Do you believe there is another alternative for distinguishing revenue and expense transactions? If so, please describe that alternative and explain why you believe it would be suitable.

APPENDIX A—EXAMPLES

A1. The models described in this Invitation to Comment would classify revenue and expense transactions on the basis of whether a transaction either (a) is exchange or nonexchange or (b) contains a performance obligation or does not contain a performance obligation. Once the transaction is classified, revenue or expense would be recognized as provided in each model. These examples illustrate how the two models described in this Invitation to Comment would classify and recognize three transactions. These examples are illustrative only and do not indicate the GASB's preference for one model over another.

Example 1—Property Taxes

A2. A city levies a property tax on real property the first day of its fiscal year, at which time it has an enforceable legal claim.

Exchange/Nonexchange Model

A3. The city would classify this transaction as nonexchange because the value provided by the taxpayers would not equal the value of the services they receive from the government. Recognition of revenue would be based on the provisions of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended, for imposed nonexchange revenues. This classification and recognition would be consistent with existing recognition requirements.

Performance Obligation/No Performance Obligation Model

A4. The city would classify this transaction as not containing a performance obligation because it does not meet multiple aspects of the definition of a performance obligation. The beneficiary is not specific, the services provided with property tax resources are not distinct, and the rights and obligations do not articulate in equivalent terms. Generally, property taxes are used to provide broad governmental services to the citizenry and are calculated on the value of the property; for these reasons, property taxes would be classified as not containing a performance obligation. As with the exchange/nonexchange model, recognition of revenue would be based on the provisions of Statement 33, as amended, for imposed nonexchange revenues. Therefore, recognition of revenue would be consistent with existing standards.

Example 2—Utility Expense and Revenue

A5. A stand-alone public electric utility purchases electricity wholesale and distributes it to industrial and residential customers within its geographic service area. The terms of the utility's supply contract provide that the utility is responsible for payment according to the amount of electricity taken from its supplier. Likewise, the utility's billings to its customers are based on the quantity of electricity delivered.

Exchange/Nonexchange Model

A6. The utility would classify both transactions as exchange, for the purchases and sales of electricity, because the values received and given are considered to be equal in both cases. The utility would recognize both expense and revenue as follows:

- *Expense*—According to the utility's supply contract, expense would be recognized as the utility takes electricity from its supplier. It is at that time that the utility has an obligation that it has little or no discretion to avoid, and the outflow is not applicable to a future reporting period.
- *Revenue*—According to customer billing terms, the utility would recognize revenue when the utility delivers electricity to its customers. It is at that time that the utility has a resource with present service capacity that the utility presently controls (a receivable from customers) and an inflow is not applicable to a future reporting period.

Performance Obligation/No Performance Obligation Model

A7. The utility would classify both transactions as containing performance obligations as follows:

- *Expense*—The utility has a binding arrangement with the supplier in which the legally enforceable terms articulate on the same basis (the charges would be based on the amount of electricity purchased). The goods are distinct because electricity is provided in a series and the utility is the beneficiary.
- *Revenue*—The utility has a binding arrangement with its customers in which the legally enforceable terms articulate on the same basis (the charges to the customers are based on the amount of electricity consumed by the customer). The goods are distinct because electricity is provided in a series. The beneficiary of the transaction is specific, each individual customer.

A8. The utility would recognize both expense and revenue as follows:

- *Expense*—Recognition would occur when the utility takes electricity from the supplier because the supplier has performed its obligation to the government and the outflow is applicable to the reporting period.
- *Revenue*—Recognition would occur when the utility delivers electricity to the customer because the utility has performed its obligation to its customer and the inflow is applicable to the reporting period.

Example 3—Grant

A9. A state agency is awarded a grant from a federal agency, on a reimbursement basis, to purchase police tactical vests. The grant stipulates that the vests are required to be used by the state agency public safety personnel. The grant agreement specifies the number of vests to be purchased and that the grantor will reimburse the state agency for 100 percent of the cost. Once the agreement is executed, the state agency purchases the vests and requests reimbursement from the federal agency.

Exchange/Nonexchange Model

A10. The grant would be classified as a nonexchange transaction because the state agency is receiving value without giving equal value in exchange. The transaction would be further classified as a voluntary nonexchange transaction, pursuant to the provisions of Statement 33, as amended.

A11. Regarding revenue recognition, the state agency would need to assess whether it meets the eligibility requirements in paragraph 20 of Statement 33. The federal and state agencies, when entering into the grant agreement, would have assessed the required characteristics of the recipient (paragraph 20a) to ensure the state agency is eligible to receive the grant. Furthermore, the grant is provided on a reimbursement basis. Time requirements and contingencies (paragraphs 20b and 20d, respectively) are not applicable. For these reasons, the state agency would recognize revenue when it purchases the vests (paragraph 20c).

Performance Obligation/No Performance Obligation Model

A12. The grant would be classified as containing a performance obligation because the obligation by the state agency to purchase vests is a promise in a binding arrangement between the state agency and the federal agency grantor. This classification would be different from the exchange/nonexchange model and, therefore, the recognition approach used would be based on the performance obligation approach (instead of following the provisions of Statement 33, as amended). The grant is a binding arrangement with rights and obligations that articulate in equivalent terms for a distinct good. The federal agency has stipulated the number of vests that would be reimbursed at 100 percent of the cost; therefore, those rights and obligations articulate in equivalent terms. Each tactical vest is a distinct good because the state agency can benefit from each good independently. The state agency is the specific beneficiary because it can be specifically identified.

A13. Revenue would be recognized when the state agency purchases the vests, as the transaction is applicable to the reporting period and it has fulfilled its performance obligation to purchase tactical vests for the use of its safety personnel.

APPENDIX B—BACKGROUND INFORMATION

History of Guidance on Revenue and Expense Transactions

Nonexchange Transactions

B1. In 1998, the GASB addressed nonexchange transactions by issuing Statement 33. In issuing Statement 33, the GASB anticipated revisions to the financial reporting model in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* Statement 34 was issued in 1999. Nonexchange transactions are common governmental transactions and include all forms of taxation, many grants, and some other intergovernmental transactions (such as a state government's payments to local school districts in support of education). Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*, was issued in 2000 and made clarifying amendments to Statement 33.

Exchange Transactions

B2. The existing guidance for exchange transactions in Statement 34 is limited. Statement 34 provides that revenues and expenses should be recognized when an exchange takes place (paragraph 16). Further guidance is established for revenues in Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* issued in 2010. According to Statement 62, revenues should be recognized when a transaction is complete (paragraph 23). The GASB also has issued a number of specific standards that address exchange transactions, particularly for expenses. Examples include Statements No. 68, *Accounting and Financial Reporting for Pensions*, No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* and No. 87, *Leases.*

Post-Implementation Review of Statements 33 and 36

B3. In November 2015, the trustees of the Financial Accounting Foundation (FAF) issued a post-implementation review (PIR) of Statements 33 and 36. A PIR is conducted several years after a Statement has been implemented by governments and is intended to evaluate whether expectations about benefits and costs were realized, including the usefulness of the resulting information for making decisions and assessing government accountability. The evaluation also studies whether (a) preparers and auditors understand the standards, (b) preparers and auditors are able to apply the standards as intended, and (c) the standards enable information to be reported reliably.

B4. The PIR on Statements 33 and 36 concluded that the pronouncements (a) resolved the issues underlying their stated needs, (b) produced decision-useful information for users of financial statements, and (c) can be applied as intended; however, some application challenges were identified. For example, the review noted that some practitioners had trouble determining whether a transaction is exchange or nonexchange. The complete report is available at the FAF's website here. This is significant because both models discussed in this Invitation to Comment would retain the requirements of Statement 33, as amended. Whether and how those requirements could be modified will be addressed later in this project.

FASB's and IASB's Performance Obligation Approach

B5. In 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* to amend *FASB Accounting Standards Codification*® Topic 606, Revenue from Contracts with Customers. This ASU establishes the performance obligation model as the basis for revenue recognition, replacing large portions of the existing FASB revenue recognition standards. The International Accounting Standards Board (IASB) adopted a similar standard when it issued International Financial Reporting Standard 15, *Revenue from Contracts with Customers.* These two standards were the result of an FASB and IASB convergence project. The goal of that project was for the FASB and IASB to issue equivalent accounting standards. The GASB has monitored both the convergence project and the implementation of the performance obligation approach as provided in those standards, considering how it could be applied in the public sector.

IPSASB Revenue and Nonexchange Expenses Projects

B6. The GASB also has been monitoring the work of the International Public Sector Accounting Standards Board (IPSASB) as it develops a potential standard(s) that would address revenue and nonexchange expense recognition. The IPSASB issued a Consultation Paper in August 2017, *Accounting for Revenues and Non-Exchange Expenses*. That document includes proposals that involve the application of a performance obligation model adapted to the public sector. The GASB will continue to monitor these IPSASB projects.

Pre-Agenda Research

B7. In September 2015, the Board initiated research on revenue and expense issues. The research considered the following:

a. Whether the existing guidance regarding revenue recognition for exchange transactions is sufficient to minimize diversity in practice
b. What constitutes exchange-like transactions and how they should be accounted for
c. Whether there is an opportunity to harmonize revenue recognition standards with the recently issued FASB standards.

B8. The research included (a) a review of the relevant standards of the GASB and other standards setters, (b) analysis of revenue information of governments published by the U.S. Bureau of the Census, and (c) surveys of preparers, auditors, and users of governmental financial statements. The review of existing standards indicated that there is limited guidance for revenue recognition in exchange transactions. The research also confirmed the PIR finding that it is sometimes difficult to distinguish between exchange, exchange-like, and nonexchange transactions.

B9. The research noted that most government revenue comes from nonexchange transactions. The 2012 U.S. Census of Governments—at the time of the research, the most recent data—indicated that 46 percent of government revenue was generated through taxes, whereas 19 percent was from intergovernmental sources. Although some intergovernmental revenues may be exchange or exchange-like, much of that category likely is nonexchange. Combining those two categories, approximately 65 percent of state and local government revenues were generated from nonexchange transactions. Utility charges and general charges likely came from exchange transactions; they constituted a combined 19 percent of total revenues. The remaining two categories of insurance trust and miscellaneous revenues may include both exchange and nonexchange transactions.

B10. The surveys of preparers and auditors indicated some diversity in practice. Specifically, some preparers recognize the same transactions, such as utility fees, at different points in time. Some recognize a transaction when a good or service was "sold," and others when an obligation to the customer is fulfilled.

B11. The survey of financial statement users indicated that generally all types of users benefit from information related to revenue and expense from exchange and nonexchange transactions. For example, information about revenue from exchange transactions is compared with the costs to provide the related services. Respondents to the user survey indicated that they rely on information about revenue from exchange transactions to evaluate trends in revenue sources, as well as a government's reliance on those sources.

Revenue and Expense Recognition Project

B12. Taking the foregoing into consideration, the Board added a project on revenue and expense recognition to its current technical agenda in April 2016. The Board assembled a task force for the project composed of members broadly representative of the GASB's stakeholders. The task force members provided feedback on issues discussed by the Board and on drafts of this Invitation to Comment. The Board also met with the task force in a public meeting in August 2017. In addition, feedback was provided by members of the Governmental Accounting Standards Advisory Council at six of its seven meetings between November 2015 and October 2017.