



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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DATE: 20 JUNE, 2003  
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE  
FROM: RICK NEVILLE & MATTHEW BOHUN  
SUBJECT: **ITC REVENUE FROM NON-EXCHANGE TRANSACTIONS**

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**ACTION REQUIRED**

The Committee is asked to:

- **review** the draft Invitation to Comment; and
- **advise of any suggestions for amendment.**

**AGENDA MATERIAL:**

	<b>Pages</b>
9.2 Extract from the draft minutes of the PSC meeting in Melbourne in April 2003.	9.4-9.7
9.3 A proposed <i>ITC - Revenue from Non-Exchange Transactions</i> .	9.8-9.94
9.4 Copies of comments received from: <ul style="list-style-type: none"><li>▪ Ken Warren;</li><li>▪ Ian Carruthers and David Watkins;</li><li>▪ Marianne Brown; and</li><li>▪ Australian Accounting Standards Board</li></ul>	

At the previous meeting, we presented a partial draft of the proposed ITC. The PSC made a number of recommendations concerning the draft as it was then. The Steering Committee Chair and Staff met in May, to resolve these issues and we have endeavored to include those changes in the current draft.

The current draft has been slightly restructured and no longer includes a separate chapter on definitions, which are now included within the text in the introductory chapter. The Steering Committee members have had an opportunity to review the first three chapters and provide comments on them; these comments are attached. The attached draft includes some of the less complex suggested amendments made by the Steering Committee members, however the more complex suggested amendments are still under review.

Steering Committee members will have an opportunity to review the entire draft prior to the meeting and any additional comments will be circulated to the PSC with the second distribution of agenda materials, or prior to the meeting in Vancouver.

The Steering Committee members have tentatively decided to meet in Paris at the Ministry of Finance Conference Center from 3 – 5 September, 2003 to finalize the draft ITC for your approval at the PSC meeting in Berlin in November.

At this meeting we would like you to consider the draft ITC in detail and draw to our attention any concerns you have with the draft that should be brought to the attention of the Steering Committee.

### **Structure of Draft and Major Changes**

The **Executive Summary** has not been significantly amended due to time constraints; the PSC's request to give more prominence to grants due to their prominence in Chapter 5 Transfers has not been implemented. The PSC may wish to review this request in light of their reading of Chapter 5, which focuses more on Transfers as a generic class of transactions rather than on grants, in particular.

Chapter 1 – Introduction, was only available in outline format at the meeting in Melbourne; it has now been drafted in full. The chapter outlines the basic approach to the recognition and measurement of revenue from non-exchange transactions adopted by the Steering Committee. The introduction also includes the definitions previously included in a separate chapter.

Chapter 2 – Principles, details the approach adopted. The changes requested by the PSC have been made to the chapter. In particular the Steering Committee is taking a stronger view on the amending IPSASs 12, 16 and 17 and reviewing the approach to “contributions from owners”.

Chapter 3 – Stipulations, details when entities should recognize liabilities in relation to stipulations on assets. Several Steering Committee members have concurred with the PSC's view on the issue of timing restrictions and have indicated that they wish to debate the matter further.

Chapter 4 – Taxes, was only available in outline format previously; it has now been drafted in full. PSC members are requested to note the example in Appendix 1 on income tax to illustrate how the Steering Committee members envisage that principles in Chapters 2 and 3 would be applied to a particular tax.

Chapter 5 – Transfers, was also only available in outline format previously. The chapter notes that appropriations and grants are particular types of transfers but does not define either term, as the Steering Committee members have previously noted that the meaning attached to the terms varies widely from jurisdiction to jurisdiction. Grants are not as prominent as the chapter outline presented in Melbourne indicated; therefore the Executive Summary may not need to give them greater prominence.

Chapter 6 – Other Revenue, was available in outline format previously; it provides preliminary views on how revenue from a number of common non-exchange transactions should be measured. The Steering Committee members have taken the view that assets and liabilities should, on initial recognition, be measured at their fair value, given that in a non-exchange transaction historic cost is not relevant.

Chapter 7 – Implications for IPSAS 9, presents the implications for IPSAS 9 of the preliminary views expressed, and the IASB revenue project. As stated at the meeting in Melbourne, the Steering Committee members are of the view that there should be only one IPSAS on revenue. However, it should be noted that an IPSAS on non-exchange revenue should not be unduly delayed in order that a single revenue IPSAS be developed.

Appendix 1 – Examples of Revenue from Non-Exchange Transactions, is still incomplete. However, the first example has been drafted so that you may see how the others will be developed.

### **Update on Members**

Rick Neville has changed jobs; he is now the Vice President – Finance and Administration and Chief Financial Officer, Royal Canadian Mint.

Natalie Dolezalova has been seconded from the Czech Ministry of Finance to the Directorate-General – Budget, of the European Commission to take part in the implementation of the IPSASs in the EC financial statements. The European Commission is not represented on any of the Steering Committees at present.

### **Rick Neville**

**CHAIR, NON-EXCHANGE REVENUE STEERING COMMITTEE**

### **Matthew Bohun**

**TECHNICAL MANAGER, NON-EXCHANGE REVENUE STEERING COMMITTEE**

## 9. DRAFT ITC REVENUE FROM NON-EXCHANGE TRANSACTIONS

The PSC received and considered:

- a memorandum from Rick Neville, the chair of the Non-Exchange Revenue Steering Committee;
- an incomplete draft ITC *Revenue from Non-Exchange Transactions* which contained:
  - outlines for the introductory chapter; the chapters on the proposed accounting treatment of revenue from taxation, grants, and other non-exchange transactions; and a chapter dealing with the effect on IPSAS 9;
  - complete chapters on definitions and principles for the recognition and measurement of revenue from non-exchange transactions;
- notes providing more detail on the proposed treatment of revenue from taxation, grants and other non-exchange transactions.

Rick reported on the work of the Steering Committee since the PSC's last meeting in Hong Kong in November. He noted that:

- the Steering Committee had their third meeting on 24 – 26 February 2003 in London at HM Treasury;
- Keith Alfredson, Chair of the Australian Accounting Standards Board attended as an observer to present the Australian viewpoint;
- staff from the International Accounting Standards Board attended the first day of the meeting and briefed the Steering Committee on the IASB's current revenue project, which proposes amending IAS 18 *Revenue*, to reflect a balance sheet approach to the recognition of revenue, this would be more in harmony with the IASB *Framework for the Preparation of Financial Statements*;
- at the meeting in February, the Steering Committee proposed substantial revisions to the draft ITC it considered; and
- the time between the meeting in February and the mail out for this meeting was very short and did not enable the staff to complete redrafting the entire ITC. However, staff have completed, and Steering Committee members have reviewed, the definitions, principles for recognition and measurement, and the outline of the chapters of the ITC.

Rick outlined the approach adopted, noting that:

- the draft ITC applies the definitions, and the recognition criteria of assets and liabilities from existing IPSASs;
- the draft ITC proposes definitions for: “exchange transactions”, “non-exchange transactions” and “control of an asset”;
- the draft ITC uses a flowchart to illustrate the proposed approach to the recognition and measurement of revenue from non-exchange transactions;
- the draft ITC develops an approach to the recognition of revenue, which focuses on recognizing increases in net assets. The Steering Committee envisages this approach could be applied equally to revenue arising from non-exchange or exchange transactions. In light of this, and the IASB project reviewing IAS 18 *Revenue*, the

Steering Committee is of the view that in the long term there should only be one IPSAS on revenue;

- the Steering Committee is of the view that revenue should be measured at the fair value of the increase in net assets. The Steering Committee noted that this will not always be possible unless IPSAS 12 *Inventories*, IPSAS 16 *Investment Property* and IPSAS 17 *Property, Plant and Equipment* are modified to allow entities to initially recognize assets at fair value in all circumstances;
- the draft ITC proposes guidance on when a transfer is to be recognized as a “contribution from owners” as defined in IPSAS 1. The proposal is that a “contribution from owners” needs to be designated and documented as such by the transferor;
- the draft ITC includes guidance on how a transfer with stipulations attached is to be recognized initially – either as revenue or as a liability depending on the circumstances and whether subsequently revenue is recognized as conditions are fulfilled, or a liability is recognized if conditions are breached;
- that taxes are a major public sector specific issue and will be treated in some detail. In particular the ITC would note that:
  - where the tax system is used as a payment system to pay benefits to taxpayers that others receive in some other form, revenue should be grossed up in respect of those payments, and a separate expense recognized;
  - the taxable event, that is the event that gives rise to a taxation revenue, should be focused upon as the earliest possible point at which revenue can be recognized. For example, taxpayers earning income during a taxation accounting period would be the taxable event for income taxes;
  - control of tax assets does not always arise at the time the taxable event occurs, and the entity may need to delay recognition until control over the tax assets is obtained;
  - an entity is not always able to reliably measure tax assets at the time the taxable event occurs and the entity may need to delay recognition until it can reliably measure the tax assets;
  - the probability of assets flowing to the entity as a result of a taxable event may be low, requiring the entity to delay recognition until the flow is more probable than not, which may mean that in some circumstances revenue is not recognized until cash or a tangible asset is received by the entity;
- transfers, including grants and appropriations will also be discussed in detail. The ITC will note that:
  - transfers are often subject to stipulations;
  - the appropriations framework in different jurisdictions varies greatly, and entities will need to determine whether, in their jurisdiction, an appropriation gives rise to an increase in net assets, and revenue, or whether a subsequent event needs to occur before an increase in net assets and revenue are recognized;
  - third party settlements will be treated in the same manner as in the Cash Basis IPSAS;
- the ITC will deal with a number of public sector revenues separately including:
  - the sale and purchase of goods at subsidized prices;
  - loans at subsidized interest rates;

- pledges; and
- voluntary services.

The PSC discussed the ITC and:

- agreed that in both this ITC and other ITC's the note beneath the list of Steering Committee members should also state that the views expressed in the ITC are not the views of members' employers or sponsoring entities;
- recommended that revenue from grants be given more prominence in the Executive Summary given its prominence in the chapter on transfers;
- commented that the reference in the introductory chapter to moving to one IPSAS may be pre-empting the discussion later in the ITC. It was noted that this was a deliberate decision of the Steering Committee. The PSC also noted that the distinction between exchange and non-exchange is relevant for the purposes of defining the scope of the Steering Committee's work, but it does not necessarily imply that the distinction is necessary for determining how a particular transaction should be treated;
- questioned the need for the definition of "non-exchange transaction" to include the second sentence which notes that entities both give and receive value without respectively receiving or giving approximately equal value in return. It was explained that the Steering Committee considered that it was insufficient to make a simple statement that a non-exchange transaction is not an exchange transaction. The distinction between public sector entities giving as well as receiving was considered necessary because Social Policy Obligations Steering Committee would be using the same definition;
- suggested that the elements of control could be brought out more in paragraphs 3.10 and 3.11 and that the ITC should emphasize that "regulate" does not refer to a government's statutory/regulatory role, but its role as owner/controller of a specific asset;
- agreed in relation to paragraphs 3.12 to 3.14 that the purpose of this project is not to determine the appropriate reporting regime for "administered assets" and that the ITC should note the existence of such arrangements, but not specify the reporting requirements for such items;
- suggested that in paragraph 3.17 a less contentious example be used;
- noted in relation to paragraph 3.21 that both "probable" and "more likely than not" are used, both here and throughout the document. The PSC suggested that the ITC use only one term and use it consistently;
- suggested in relation to paragraph 3.23 that the Steering Committee make a stronger recommendation in relation to the revision of IPSASs 12, 16 and 17;
- discussed the concept of "ownership" in the public sector (refer paragraphs 3.24 to 3.27). Several members were not entirely convinced of the relevance of such a concept in the public sector. It was explained that this had been discussed and similar views were aired. It was pointed out that the definition of "revenue" from IPSAS 1 refers to "contributions from owners", which is also defined in IPSAS 1, and that a standard on revenue must, of necessity, deal with contributions from owners. The PSC suggested that the Steering Committee review the terminology "contributions

from owners” with a view to making a recommendation to the PSC whether it should be revised and how;

- agreed in relation to paragraph 3.27 that a contribution from owners does not necessarily have to be provided by a controlling entity, and that the reference to the controlling entity should be removed;
  - noted that the footnotes on page 9.27 should be deleted;
  - agreed that the Steering Committee review paragraph 3.37 to ensure that its intention is clearly reflected in the drafting;
  - agreed that Preliminary View 1 be clarified with respect to an increase in net assets due to a revaluation of assets;
  - noted that in paragraph 3.51 the term “no realistic alternative” is use in relation to liabilities, elsewhere the term “little alternative” is used, the PSC recommended that consistent terminology be used;
  - suggested in relation to paragraphs 3.52 to 3.60 that the ITC discuss further the features of a liability and the entity’s “power to decide” the disposition of an asset;
  - suggested, in relation to paragraph 3.58, that there are two views relating to revenue arising from the transfer of an asset conditional upon a matching contribution:
    - firstly an assumption that the matching contribution will be made, and
    - secondly no assumption concerning the matching contribution.
- It was agreed that both views should be presented in the ITC;
- suggested that there is an alternative view to that proposed in paragraph 3.59, that is that the provision of goods to third parties is in substance the provision of services to the donor and therefore
  - satisfies a liability, it was agreed that the ITC should canvass this alternate view;
  - noted that the treatment proposed in paragraphs 3.61 to 3.66 for timing requirements is an example of the matching principle that is not endorsed by the PSC. The arguments presented in this are not convincing and the PSC recommended that the Steering Committee review this section and/or propose alternatives for debate;
  - noted that the outline to chapter 4 does not discuss the tax gap which the introduction stated it would, and suggested that capital gains tax be discussed as a particular kind of tax; and
  - agreed that in relation to voluntary services received, alternative accounting treatments be discussed.

***Action Required:***

***Proceed with the preparation of a draft ITC for the July 2003 meeting. Arrange Steering Committee meetings and prepare Steering Committee papers.***

***Person(s) Responsible:***

***SC Chair, Standards Staff.***

**DRAFT AS OF 20 JUNE 2003**

Issued ~~Month~~ December 2003

Invitation to Comment

IFAC  
Public  
Sector  
Committee

Revenue from  
Non-Exchange  
Transactions  
(Including Taxes,  
Transfers and Grants)

Issued for  
comment by  
the International  
Federation of  
Accountants





## **Commenting on this Invitation to Comment**

This Invitation to Comment of the International Federation of Accountants (IFAC) was prepared by the Steering Committee on Non-Exchange Revenue (the Steering Committee) on behalf of the Public Sector Committee (PSC). It represents the majority views of the Steering Committee and has been approved for publication as an Invitation to Comment by the PSC.

The aim of the PSC in publishing this document is to canvas a broad range of views on the most appropriate accounting treatment for public sector revenue, prior to the preparation of an Exposure Draft of an International Public Sector Accounting Standard.

Comments are invited on any aspect of this Invitation to Comment (ITC). In particular, respondents are asked to provide clear views on whether they agree or disagree with the preliminary views in this paper, and the reasons why. Comments should be submitted in writing so as to be received by 1 June 2004. E-mail responses are preferred. Unless respondents specifically request confidentiality, their comments are a matter of public record once the Public Sector Committee has considered them. Comments should be addressed to:

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## Steering Committee on Non-Exchange Revenue

**Richard Neville**, Deputy Controller-General, Treasury Board of Canada, (Chair from January 2003, member of the PSC).

**David Rattray**, Assistant Auditor-General, Office of the Auditor General of Canada, (Chair to December 2002, former member of the PSC).

**David Bean**, Director of Research and Technical Activities, Governmental Accounting Standards Board, United States of America.

**Marianne Brown**, Member of the Accounting Standards Board, South Africa.

**Ian Carruthers**, Head of the Whole of Government Accounts Programme, Her Majesty's Treasury, United Kingdom.

**Natalie Dolezalova**, Specialist (Accounting Methodology for Budget Institutions), Accounting Department, Ministry of Finance, Czech Republic.

**Curt Johansson**, Senior Analyst, National Financial Management Authority, Sweden.

**Pablo Maroni**, (Associate), Ministry of the Economy, Argentina.

**Caroline Mawhood**, Fédération des Experts Comptable Européen (FEE), Assistant Auditor General, National Audit Office, United Kingdom.

**Lionel Vareille**, Accounting Standards Project Team, Ministère de l'Economie, des Finances et de l'Industrie, France.

**Ken Warren**, Chief Accounting Advisor, New Zealand Treasury.

**Teng Xiaguang**, Ministry of Finance, People's Republic of China.

*Members of the Steering Committee are appointed in their personal capacity rather than as representatives of their nominating body. The views expressed in this ITC are those of the members, and not those of their employers or nominating organizations.*

Item 9.3 Draft Invitation to Comment Revenue from Non-Exchange Transactions  
(including Taxes, Transfers and Grants)  
PSC Vancouver July 2003

**INVITATION TO COMMENT**

**REVENUE FROM  
NON-EXCHANGE TRANSACTIONS  
(INCLUDING TAXES, TRANSFERS AND GRANTS)**

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## Executive Summary

The Steering Committee on Non-Exchange Revenue (the Steering Committee) of the Public Sector Committee (PSC) has prepared this Invitation to Comment (ITC) on behalf of the PSC to elicit views on how revenue from non-exchange transactions received or receivable by public sector entities should be recognized and measured in their general-purpose financial statements. Most public sector entities derive the majority of their revenue from non-exchange transactions. The PSC considered that, as the issue of recognition of revenue from non-exchange transactions, including taxes, grants and transfers, was of such importance to the public sector it was necessary to form a Steering Committee to examine the issues in depth.

The Steering Committee has defined “non-exchange transactions” thus:

***A non-exchange transaction is a transaction that is not an exchange transaction. In a non-exchange transaction, a public sector entity either receives value from another party without directly giving approximately equal value in exchange or gives value to another party without directly receiving approximately equal value in exchange.***

The Steering Committee has taken an approach to the recognition and measurement of revenue from non-exchange transactions that focuses on changes in the statement of financial position. The preliminary view of the Steering Committee is that revenue from non-exchange transactions should be recognized when a public sector entity recognizes an inflow of resources, either an increase in an asset, or a decrease in a liability, and that revenue should be measured at the fair value of the increase in resources. The inflow of resources would need to meet the recognition criteria for an asset (or decrease in a liability) before revenue could be recognized.

Entities would undertake an analysis of a transaction, determining:

- first, if the transaction is exchange or non-exchange;
- second, if the definition of an asset and its recognition criteria are met (alternatively if a decrease in a liability has occurred);
- third, whether the entity should recognize a liability in respect of that inflow;
- fourth, whether the entity should recognize a contribution from owners in respect of that inflow; and

- recognize revenue in respect of the inflow if neither a liability nor a contribution from owners is recognized.

This ITC also discusses issues related to revenue from non-exchange transactions such as:

- stipulations, including restrictions and conditions;
- the “tax gap”;
- tax expenditures; and
- timing of recognition and measurement of taxation revenue.

Although the Steering Committee has carefully considered these issues, which have been reviewed by the PSC, the views that have been formed are preliminary only, and the PSC welcomes the views of its constituents on the issues raised in this ITC.

### **Specific Matters for Comment**

PSC AND STEERING COMMITTEE MEMBERS ARE ASKED TO GIVE CONSIDERATION TO SOME QUESTIONS TO ASK HERE. THE QUESTIONS BELOW ARE QUESTIONS THAT OCCURRED TO STAFF – THESE QUESTIONS NEED TO BE REVIEWED BY THE STEERING COMMITTEE.

1. Do you agree with the approach to the recognition of revenue from non-exchange transactions that has been proposed in this ITC? That is, do you agree that revenue should be recognized when a public sector entity recognizes an increase in assets (decrease in liabilities) that does not arise from a contribution by owners?
2. Do you agree that public sector entities should be permitted to designate a transfer to a controlled entity as a contribution from owners as outlined in paragraph 2.27?
3. Do agree that the concept of “contribution from owners” needs to be enhanced to encompass unique public sector circumstances? If you do not think the concept is applicable, how would you describe and define a direct transfer to the “net assets/equity” portion of the statement of financial position? Do you think that a government can make a contribution of net assets/equity into a public sector entity?
4. Do you agree with the Steering Committee’s conclusions regarding stipulations? Do you agree that stipulations give rise to liabilities in the circumstances described?
5. Do you agree that the PSC should move to develop one IPSAS on revenue that includes both exchange and non-exchange transactions within its scope? Should the PSC delay development of an IPSAS on revenue from non-exchange transactions pending the outcome of the IASB’s project on revenue? Alternatively, should the PSC proceed to issue an Exposure Draft and IPSAS on revenue from non-exchange transactions and then consider the outcome of the IASB revenue project?

## Chapter 1 Introduction

- 1.1. The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) established the Non-Exchange Revenue Steering Committee (the Steering Committee) to develop an International Public Sector Accounting Standard (IPSAS) on revenue from non-exchange transactions. The PSC's brief to the Steering Committee was to develop an IPSAS:
- (a) that deals with all revenue other than revenue arising from exchange transactions;
  - (b) includes a definition of "non-exchange transaction";
  - (c) identifies whether a non-exchange transaction gives rise to revenue of the recipient;
  - (d) proposes general principles for the recognition and measurement of revenue from non-exchange transactions including:
    - (i) the implications of stipulations imposing conditions, restrictions or timing requirements;
    - (ii) pledges; and
    - (iii) non-monetary assets; and
  - (e) identifies any disclosures required, in addition to those that are required by IPSAS 1.
- 1.2. The purpose of this Invitation to Comment (ITC) is to seek comments on the Steering Committee's proposed principles for the recognition and measurement of revenue from non-exchange transactions by public sector entities preparing general-purpose financial statements using the accrual basis of accounting.

### *Background to the Project*

- 1.3. The first phase of the PSC's standard setting workplan extended from 1996 to June 2002, and was focused on developing a core set of recommended accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The PSC recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs play a key role in enabling these benefits to be realized. These IPSASs are



based on the International Financial Reporting Standards (IFRSs), or International Accounting Standards (IASs), issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those standards are applicable to the public sector. During this phase of the workplan the PSC issued twenty accrual-based IPSASs. In the course of developing these IPSASs the PSC identified a number of accounting issues of particular importance to the public sector that are not adequately addressed in the IFRSs or IASs. With the near completion of the first phase of the workplan, the PSC now intends to address these issues as a matter of priority.

- 1.4. As part of the first stage of its standard setting program, the PSC issued IPSAS 9 *Revenue from Exchange Transactions*; that IPSAS does not address the recognition and measurement of revenue from non-exchange transactions in that Standard.

## Scope

- 1.5. The scope of this ITC has been established by the PSC and is noted in paragraph 1.1. However, it should be noted, that like IPSASs, this ITC does not consider the application of the principles proposed to Government Business Enterprises (GBEs). GBEs are required to comply with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). In the IPSASs already on issue the PSC has directed GBEs to apply IFRSs as they are relevant to all business enterprises, regardless of whether they are in the private or public sector. Whilst GBEs do not apply IPSASs, the public sector entities that control GBEs are required to apply IPSASs, and to apply consistent accounting policies when preparing consolidated financial statements in accordance with IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities*. Therefore, public sector entities that control GBEs may need to consider how the principles proposed in this ITC may affect GBEs.

## Definitions

- 1.6. The Steering Committee, in developing its proposed principles, first looked to the existing definitions of the elements of general purpose financial statements in IPSAS 1 *Presentation of Financial Statements*, and sought to apply the principles in those definitions to non-exchange transactions. These definitions are

reprinted in the *Glossary of Defined Terms IPSASs 1 – 20* published separately.

- 1.7. The definition of “revenue” is central to the approach the Steering Committee has adopted in developing principles for the recognition and measurement of revenue from non-exchange transactions. IPSAS 1, paragraph 6, states that:

***Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.***

- 1.8. IPSAS 9 *Revenue from Exchange Transactions* establishes how this definition is to be applied to exchange transactions. This ITC proposes principles to establish how this definition is to be applied to all other revenue. When applying this definition the Steering Committee considers it important to consider the increase in net assets (an increase in assets, a decrease in liabilities or a combination thereof), which requires entities to focus on the definition and recognition criteria of assets and liabilities. The Steering Committee also considers it necessary to discuss the nature of “contributions from owners” in the public sector.
- 1.9. The preliminary views expressed in the ITC propose an IPSAS that establishes general principles for the recognition and measurement of revenue from non-exchange transactions that can be applied in a variety of circumstances. The Steering Committee does not propose that an IPSAS be developed that gives precise instructions for recognizing and measuring every conceivable type of revenue from non-exchange transactions. To adopt the latter approach would necessarily require a lengthy standard that may not address all the different types of revenue that exist now, or will exist in the future. It is not possible for an IPSAS to address all the possible variations of revenue that exist in every jurisdiction. The preliminary views proposed in this ITC state that it is more appropriate to develop general recognition and measurement principles that can be applied in particular jurisdictions to a variety of classes of revenue.

1.10.

*Distinguishing between Exchange and Non-Exchange Transactions*

- 1.11. It should be noted that in some jurisdictions the term “reciprocal” and its opposite “non-reciprocal” are used instead of “exchange” and “non-exchange”. The PSC has previously adopted “exchange” and “non-exchange” and that approach is continued in this ITC. The Steering Committee considers that the different terms would have the same meaning.
- 1.12. The distinction between revenue from non-exchange transactions and exchange transactions has been important in determining when revenue is recognized. Past approaches have generally been to recognize revenue from non-exchange transactions when control is obtained over the economic benefits flowing to the entity. However, IPSAS 9 requires that revenue from exchange transactions be recognized when substantially all the risks and rewards of ownership of goods sold is passed to the purchaser or the services sold are rendered to the purchaser. The different approaches to recognizing exchange and non-exchange transactions leave open the possibility that entities will treat transactions with similar characteristics differently depending on whether they are classified as exchange or non-exchange.
- 1.13. Commentary in IPSAS 9 describes exchange transactions as one in which entities directly exchange approximately equal value. From this commentary the Steering Committee has adopted the following definition of “exchange transaction”:

***An exchange transaction is one in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.***

- 1.14. Commentary in IPSAS 9 describes a non-exchange transaction by describing what it is not, that is, it is not an exchange transaction. The Steering Committee concurred with this approach and has adopted the following definition of non-exchange transactions:

***A non-exchange transaction is a transaction that is not an exchange transaction. In a non-exchange transaction, a public sector entity either receives value from another party without directly giving approximately equal value in exchange or gives value to another party without directly receiving approximately equal value in exchange .***

- 1.15. These definitions provide the basis for distinguishing between exchange and non-exchange transactions. Examples of exchange transactions include those transactions that are within the scope of IPSAS 9, namely sales of goods and services, and interest, royalties and dividends transactions. Non-exchange transactions, by contrast include those transactions by which public sector entities derive the majority of their revenue, for example taxes, transfers (including grants, appropriations and donations) and such items as fines, debt forgiveness and voluntary services. This distinction may be important, as different principles would be applied in determining when revenue is recognized.
- 1.16. Revenue derived from a non-exchange transaction often has stipulations attached that restrict the use of resources or impose conditions on the use of resources. The Steering Committee has developed a proposal that where the stipulations attached to the inflow of resources are such that they require the reporting entity to recognize a liability, revenue should be recognized as that liability is discharged. If the inflow of resources occurs without stipulations attached that inflow would be recognized as revenue immediately. The Steering Committee considers that such an approach could also be applied to revenue from exchange transactions. This approach would eventually eliminate the need for a distinction between exchange and non-exchange transactions. Adopting this approach would also ensure that exchange and non-exchange transactions are accounted for on a basis that is consistent with the underlying conceptual framework, and in accordance with the tentative conclusions being reached by the IASB in its liabilities and revenue recognition project (see paragraphs 1.29 – 1.35 below).
- 1.17. The Steering Committee is of the view that there should be one IPSAS on revenue that includes both exchange and non-exchange transactions within its scope. However, the Steering Committee is also of the view that an IPSAS dealing with the recognition and measurement is needed in the short-term and would not favor unduly delaying the issuing of such an IPSAS in order to have only one IPSAS on revenue.

*Control of an Asset*

- 1.18. In considering the issues relating to the inflow of resources that results in an increase in net assets, the Steering Committee considered it important to develop a clear concept of what control of an asset means. IPSAS 6 provides a definition of

control in relation to controlled entities. The Cash Basis IPSAS *Financial Reporting Under the Cash Basis of Accounting* also provides a definition of “control of cash”. Both of these definitions apply consistent principles to the issue, and from these the Steering Committee has developed the following definition:

***Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or regulate the access of others to that benefit.***

- 1.19. This definition is consistent with the definitions used in IPSAS 6 and in the Cash Basis IPSAS, and with the principles contained in IPSAS 11 *Inventory*, IPSAS 16 *Investment Property* and IPSAS 17 *Property, Plant and Equipment*, which all deal with the recognition and measurement of various classes of assets.

## **Outline of ITC**

- 1.20. This section outlines the remaining chapters of this ITC. Chapter 2 proposes principles for the recognition and measurement of assets, contributions from owners, liabilities and revenue from non-exchange transactions.
- 1.21. Chapter 3 discusses stipulations, including restrictions, conditions and timing requirements. It proposes principles for determining when restrictions and conditions require an entity to recognize a liability, and how such liabilities are discharged and revenue recognized.
- 1.22. Chapter 4 deals with the recognition and measurement of assets and revenues arising from taxes. Issues addressed include:
- (a) when to recognize tax assets – past “taxable” event;
  - (b) tax expenditures and when to separately recognize obligations that are settled through the tax system; and
  - (c) the difficulty of determining the probability of the inflow of resources in relation to some assets.
- 1.23. Chapter 5 deals with the recognition and measurement of assets and revenues arising from transfers (including grants and appropriations). Issues addressed include:
- (a) determining whether appropriations give rise to revenue. It should be noted that different jurisdictional approaches to

appropriations mean that, in jurisdictions where the appropriation is a transaction, different methods for recognizing appropriations may arise from a consistent application of these principles;

- (b) stipulations imposed on the transfer of resources; and
  - (c) measurement of donated non-monetary assets.
- 1.24. Chapter 6 deals with the recognition and measurement of revenues arising from other non-exchange transactions. Issues t addressed include:
- (a) whether loans extended at interests rates below market interest rates give rise to revenue for either the borrower or the lender;
  - (b) whether the sale of subsidized goods and services gives rise to revenue for the vendor;
  - (c) whether the purchase of subsidized goods and services gives rise to revenue for the purchaser;
  - (d) debt forgiveness;
  - (e) pledges;
  - (f) voluntary services; and
  - (g) development assistance.
- 1.25. Chapter 7 discusses the implications of the approach proposed in the ITC for revenue recognized under IPSAS 9, and states that the view of the Steering Committee is that the PSC should look to develop one IPSAS on the recognition and measurement of revenue based on the approach developed in this ITC.
- 1.26. Appendix 1 provides examples of how particular classes of revenue would be recognized and measured under the approach developed in this ITC. Revenue classes include:
- (a) income taxes;
  - (b) capital gains taxes;
  - (c) value added taxes;
  - (d) goods and services taxes;
  - (e) customs duties;
  - (f) gift and death duties;

- (g) property taxes;
  - (h) wealth taxes;
  - (i) grants and appropriations;
  - (j) fines; and
  - (k) fees arising from non-exchange transactions.
- 1.27. Appendix 2 will reproduce the appendix to IPSAS 1 on “Qualitative Characteristics of General-Purpose Financial Reporting”.

## **IASB Projects**

- 1.28. The IASB currently has two projects under way which overlap the scope of this ITC. The first project, and the one that may be completed first, is a project to revise International Accounting Standards IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. The IASB is proposing to revise its requirements for accounting for government grants and assistance so that the requirements are consistent with its *Framework for the Preparation and Presentation of Financial Statements*. As at 31 May 2003, the IASB had not determined its preferred view on the appropriate accounting treatment, however it has tentatively decided that if it cannot reach a conclusion it would adopt the treatment in IAS 41 *Agriculture*, which requires entities to recognize revenue from unconditional grants when the grant is receivable. IAS 41 requires revenue from conditional grants to be recognized when the conditions are met.

### *IAS 18 Revenue<sup>1</sup>*

- 1.29. The IASB also has a project under way to revise IAS 18 *Revenue*, so that it, too, is consistent with the provisions of the *Framework for the Preparation and Presentation of Financial Statements*. As at 31 May 2003, the IASB has considered four ways of looking at revenues as the basis for developing a definition of revenues:
- (a) the Gross Inflows View;
  - (b) the Liability Extinguishment View;

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<sup>1</sup> These paragraphs are taken from the IASB Update for May 2003.

- (c) the Broad Performance View; and
- (d) the Value Added View.

These views focus on the amount of revenues, rather than when it is recognized. The *Gross Inflows View* defines revenues in terms of the consideration received from the reporting entity's customers over which the entity obtains control.

- 1.30. The *Liability Extinguishment View* defines revenues as decreases in the reporting entity's liabilities to customers resulting from the extinguishment of performance obligations for which it is primarily liable at law. Those obligations are extinguished by providing goods and services to customers either directly by the reporting entity itself or indirectly by having third parties provide them on its behalf.
- 1.31. The *Broad Performance View* defines revenues as increases in the reporting entity's assets (including inflows of assets or enhancements of assets) or decreases in its liabilities resulting from activities that are integral to the provision of products (goods and services) by the entity itself that are ultimately destined for customers.
- 1.32. The *Value Added View* defines revenues as the excess of the value of the reporting entity's outputs in the form of goods and services that it creates over the costs of its inputs in the form of materials and services that it purchases from other entities.
- 1.33. The IASB tentatively agreed that:
  - (a) the definition of revenues should not be based on the Gross Inflows View or the Value Added View described above;
  - (b) the definition of revenues and the recognition criteria for revenues should be based on the same view of revenues;
  - (c) the working definition of revenues should be focus on activities related to the provision of goods and services to customers; and
  - (d) the definition of revenues should be complemented by disclosures about various aspects of the reporting entity's performance.
- 1.34. The Steering Committee noted that the IASB's plan is to issue an exposure draft at about the same time as this ITC is issued. The Steering Committee tentatively agreed that when it is

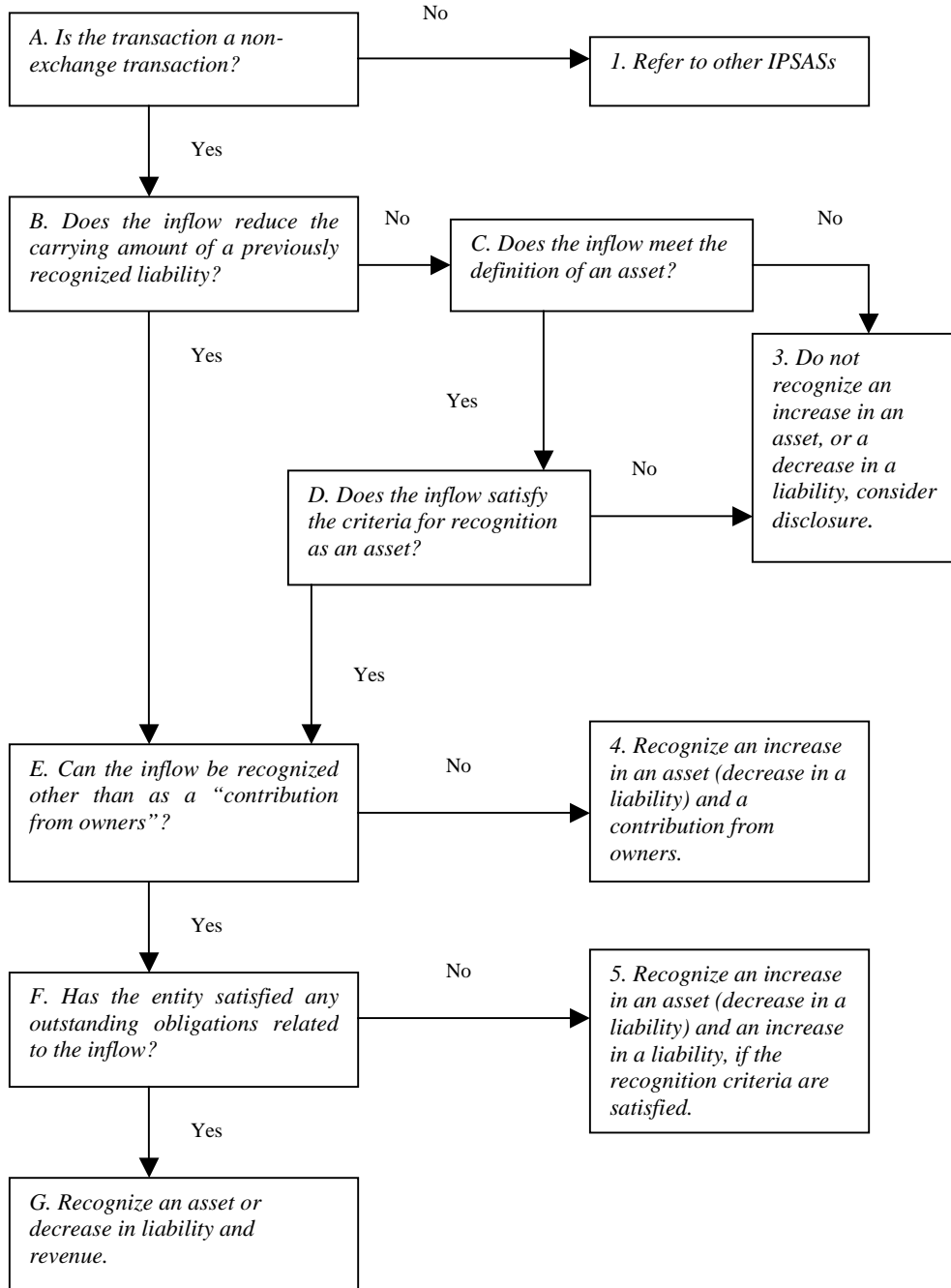


preparing an exposure draft in light of comments received on this ITC, it would examine that exposure draft and the subsequent IFRS and determine to what extent the provisions of those documents can be applied to public sector entities.

## Chapter 2 Principles

### Recognition of Revenue from Non-Exchange Transactions

- 2.1. The approach to recognition of revenue proposed in this ITC is an assets and liabilities approach, that is, when an increase in net assets arising from a non-exchange transaction that does not result from a contribution from owners occurs, revenue is recognized at the same amount as that net increase. This approach requires entities to focus on:
- (a) the past event that causes an increase in an asset or a decrease in a liability;
  - (b) whether the entity controls an asset;
  - (c) the probability of an inflow of economic benefits or service potential;
  - (d) the ability to reliably measure the inflow of resources and
  - (e) whether the inflow is a “contribution from owners”.
- 2.2. Some argue that an alternative approach primarily based on matching revenues with costs should be adopted. They suggest that the approach adopted by the Steering Committee is flawed because of difficulties in devising effective recognition rules and because the mixed measurement of assets and liabilities creates inconsistencies in the reporting of financial performance. However the approach proposed by the Steering Committee is consistent with conceptual frameworks generally adopted internationally and with international efforts to improve recognition rules and develop more consistent measurement of assets and liabilities. To match revenues with costs requires the use of a concept of earnings that will often not be applicable in the case of revenue from non-exchange transactions.
- 2.3. The following flow chart illustrates the analysis to be undertaken when there is an inflow of economic benefits or service potential to determine whether to recognize revenue:



The remainder of this chapter follows the structure of the flowchart.

**A. Is the transaction a Non-Exchange Transaction?**

- 2.4. For the purposes of this ITC, a non-exchange transaction has been defined as a transaction that is not an exchange transaction. This definition provides assurance that an applicable and relevant accounting standard applies to all revenue, whether arising by way of a non-exchange transaction or an exchange transaction.
- 2.5. Examples of non-exchange transactions include revenue from the use of sovereign powers (for example, direct and indirect taxes, duties, and fines), grants and transfers. In distinguishing between exchange and non-exchange revenues, the substance rather than the form of the transaction should be considered. For example, license fees may normally be classified as exchange transactions, however a particular license fee may be imposed in respect of a commodity or service the acquisition of which is a virtual necessity and the price of the license fee exceeds the fair value of the “license”. In this case, in substance the license fee constitutes a tax. Further, some “taxes” may in substance, be exchange transactions, for example a government may levy a “departure tax” on international passengers which represents the fair value of providing immigration and security services to those departing passengers.
- 2.6. It is likely that there will always be problems with applying the exchange/non-exchange distinction because of difficulties in making judgments as to whether:
- (a) a transaction involves approximately equal value in exchange or not, and
  - (b) whether the value is exchanged directly with the counterparty or not.
- 2.7. Under existing IPSASs, there is a distinction between revenue from non-exchange transactions and exchange transactions. This distinction may be important in determining when revenue is recognized. This is because IPSAS 9 *Revenue from Exchange Transactions* requires that revenue from exchange transactions be recognized when substantially all the risks and rewards of

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ownership of the goods sold are passed to the purchaser or as services are rendered. There is currently no explicit guidance in the IPSASs on the recognition and measurement of non-exchange transactions. However, this ITC proposes an approach to the recognition and measurement of revenue from non-exchange transactions that is different from the approach adopted in IPSAS 9 (assets/liabilities approach).

- 2.8. The Steering Committee is of the view that the distinction between exchange and non-exchange may be a matter of judgment and therefore in the longer term the better approach is to avoid unnecessary and unproductive debate by basing future IPSASs on the recognition and measurement of revenue on the concepts of assets and liabilities rather than on the exchange/non-exchange distinction.

**B. Does the inflow reduce the carrying amount of a previously recognized liability?**

- 2.9. An increase in net assets arises due to an increase in an asset, a decrease in a liability or a combination of the two. An increase in an asset is recognized when an item meets the definition of an asset and satisfies the criteria for recognition as an asset, as outlined below. In some circumstances, the increase in an asset will be fully offset by an increase in a liability, in which case there has been no increase in net assets. For example, an advance payment by a national government for a grant to a provincial government increases the provincial government's asset "cash" and also gives rise to a liability for the provincial government in respect of "grants received in advance," so there is no increase in net assets. In other circumstances, there may be a partial offset, or no offset, in which case the entity experiences an increase in net assets of the amount of the increase in assets, less the amount of any increase in liabilities recognized.
- 2.10. A decrease in a liability also results in an increase in net assets. The amount of the increase in net assets is equal to the reduction in the carrying amount of the liability. For example, if a provincial government has received grants in advance, and subsequently accrues amounts in respect of those grants, it reduces the liability "grants received in advance" and recognizes revenue in respect of the grants accrued, revenue will be measured at the amount equal to the reduction in the carrying

amount of the liability. The definition of a liability and the criteria for recognizing a liability are discussed further below.

## **C. Does the inflow meet the definition of an asset?**

### **Definition of Assets**

- 2.11. IPSAS 1 *Presentation of Financial Statements*, paragraph 6, states that:

***Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.***

Paragraphs 2.12 to 2.17 explain key aspects of this definition.

### Control

- 2.12. The definition of “control of an asset” in paragraph 1.18 contains two elements, control requires that an entity:

- (a) can use or benefit from the asset, and
- (b) can exclude or regulate the access of others to that benefit.

In determining the existence of an asset, the right of ownership is not essential - for example, property held on a finance lease is an asset if the entity controls the benefits that are expected to flow from the property. Although the capacity of the entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.<sup>1</sup>

- 2.13. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. It is important to note

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<sup>1</sup> Adapted from International Accounting Standards Committee Foundation *Framework for the Presentation of Financial Statements*, 2002, paragraph 57.

that in the public sector, governments exercise a regulatory role over public goods such as waterways, fresh air and fisheries in international waters, which may enable the government to exclude or regulate access to those public goods. This regulatory role does not necessarily mean that such regulated public goods satisfy the definition of an asset, or the criteria for recognition as an asset in the general-purpose financial statements of the government that regulates those public goods.

*Administered Assets*

- 2.14. Many entities in the public sector administer assets that they do not control. It is common for a government to delegate the administration of assets, such as taxes receivable, to specific public sector entities. These public sector entities are normally controlled by the government but may be reporting entities in their own right. A controlled entity that prepares general-purpose financial statements should only include in its own financial statements information about the resources it controls. In applying the definition of an asset and the criteria for recognition as an asset, an entity needs to consider whether it controls assets it administers on behalf of its controlling entity. If an entity determines that it does not control certain items, but rather administers them as a trustee, it should not recognize these items as assets in its financial statements.
- 2.15. Public sector entities that administer items or programs on behalf of the government are usually required to prepare and publish special-purpose financial statements in respect of these items or programs. These statements are often included in the same document as the entity's general-purpose financial statements. The information contained in these administered/trust financial statements provides information to the users of public sector financial statements about the entity's discharge of its responsibilities. As these statements provide information about resources that are not controlled by the entity, they should be presented in such a way to ensure that a clear distinction is drawn between the financial position, performance and cash flows of the entity, and the administered or trust position, performance and cash flows. In presenting these special-purpose financial statements a variety of presentation formats are possible.

Past Event

- 2.16. The assets of an entity arise from past transactions or other events. Public sector entities normally obtain assets from the government, other entities or taxpayers, or by purchasing or producing them. Therefore the past event may be a sale “taxable event”, or a transfer. Identification of a past event in determining the recognition point for taxation assets and revenues is of particular importance for governments and is discussed in chapter 4. Transactions or events expected to occur in the future do not in themselves give rise to assets - hence for example, an intention to levy taxation, or to purchase inventory is not a past event that meets the definition of an asset.<sup>1</sup> An item that possess the essential characteristics of an asset, but fails to satisfy the criteria for recognition may warrant disclosure in the notes to the general-purpose financial statements as a contingent asset (refer to IPSAS 19, paragraphs 39 – 43).

Future Economic Benefits or Service Potential

- 2.17. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential”. Assets that are used to generate net cash inflows are often described as embodying “future economic benefits”.

**D. Does the inflow satisfy the criteria for recognition as an asset?**

- 2.18. IPSAS 16 *Investment Property* and IPSAS 17 *Property, Plant and Equipment* requires that investment property and property, plant and equipment be recognized when the definition of an asset is met and when the recognition criteria are satisfied. The recognition criteria are that:
- (a) it is probable that future economic benefits or service associated with the asset will flow to the entity; and

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<sup>1</sup> Adapted from International Accounting Standards Committee Foundation *Framework for the Presentation of Financial Statements*, 2002, paragraph 58.



- (b) the fair value or cost of the asset to the entity can be measured reliably.<sup>1</sup>

2.19. An item that meets the definition of an asset may not satisfy the above recognition criteria because, for example, it is not probable that the future economic benefits or service potential will flow to the entity. For example, a taxpayer who is insolvent may have incurred taxes and the reporting entity determines that it is not probable that those taxes will be paid; therefore it does not recognize a receivable in respect of those taxes. Alternatively, the entity may not be able, on reporting date, to reliably measure the asset. For example, a testator may have bequeathed his or her entire estate to a reporting entity, but at reporting date the entity is unable to measure the fair value of that estate. In all such circumstances the entity needs to consider whether the items meet the definition of “contingent asset” in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, and should be disclosed as contingent assets, that may or may not be recognized as assets in the future.

#### Probable Inflow of Future Economic Benefits or Service Potential

2.20. In determining whether an item satisfies the criteria for recognition, an entity needs to assess the degree of certainty attaching to the flow of future economic benefits or service potential on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the future economic benefits or service potential will flow to the entity necessitates an assurance that the entity is able to use or benefit from the future economic benefits or service potential in the pursuit of its objectives.

#### Reliable Measurement of Assets

2.21. Existing IPSASs provide the basis for initial measurement of a number of classes of assets, whether arising from exchange or non-exchange transactions. Property, plant and equipment and investment property are initially measured at cost. Where the item is acquired at no cost or for a nominal cost, cost is the

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<sup>1</sup> Refer to IPSAS 16 *Investment Property*, paragraph 19 and IPSAS 17 *Property, Plant and Equipment*, paragraph 12.

item's fair value as at the date of acquisition (IPSAS 16 *Investment Property*, paragraph 23 and IPSAS 17, paragraph 23). Inventories are measured at the lower of cost, or current replacement cost where they are held for distribution at no charge or for a nominal charge; or consumption in the production of goods to be distributed at no charge or for a nominal charge (IPSAS 12 *Inventories*). The IPSASs do not define "nominal" however, the normal meaning is a "trivial" or "token".

- 2.22. The IPSASs are silent on the treatment of assets other than inventory, investment property or property, plant and equipment. It is the view of the Steering Committee that assets should be initially measured at their fair value as at the date of acquisition. IPSAS 12 assumes that inventory will be purchased in an exchange transaction. If however inventory were acquired through a non-exchange transaction at less than fair value IPSAS 12 would literally require that inventory be measured at the actual cost even if that cost is zero. IPSAS 16 and 17 state that where an asset is acquired at no cost or for a nominal cost its cost is its fair value. If however, investment property or property, plant and equipment is acquired through a non-exchange transaction at an economically significant cost (that is, at a cost that is more than nominal, but less than its fair value), IPSASs 16 and 17 would require an entity to initially measure the asset at its cost.
- 2.23. The Steering Committee is of the view that all assets should initially be measured at their fair value as at the date of acquisition. Any difference between the fair value and any consideration paid should be recognized as a revenue or expense in the period in which the asset is acquired. When determining fair value, entities would have consideration to the market in which the acquisition occurs, so that inventory, for example, is measured at the fair value in the market in which it was acquired, rather than the fair value of the market in which it is to be sold. Initially measuring all assets at fair value will require amendments to IPSASs 12, 16 and 17.

## D. Can the inflow be recognized other than as a contribution from owners?

- 2.24. As was stated in paragraph 2.16, many public sector entities receive assets as contributions from government or other public sector entities. The definition of “revenue” excludes any amount that is a “contribution from owners”, IPSAS 1 states that:

***Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:***

- (a) conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or***
- (b) can be sold, exchanged, transferred or redeemed.***

- 2.25. In the private sector, a controlling entity effectively has the option, when providing resources to a controlled entity, of determining whether that contribution of resources will be deemed a “contribution from owners”, a loan or revenue. The issue of shares to the owner will evidence a designation as a “contribution from owners”. The issue of debt instruments such as bonds, notes, debentures or loan agreements will evidence a liability. In the absence of evidence of a “contribution from owners” or a liability to owners, revenue would be recognized.

- 2.26. The Steering Committee is of the view that the same process is available in the public sector. Controlling entities in the public sector may transfer resources to a controlled entity for a variety of reasons, and depending on the public sector management model in place and the circumstances and purpose of the transfer, the transfer may be in the nature of a loan (liability), direct equity (contribution from owners) or revenue. As in the private sector, a loan agreement or other debt instrument would evidence a transfer from the controlling entity that is to be recognized as a liability. Unlike corporations in the private

sector, however, a public sector entity is unlikely to be a company with share capital that would enable it to issue new shares to its controlling entity. Public sector entities, therefore, need some basis on which to classify a transfer of resources from a controlling entity as a “contribution from owners”.

- 2.27. The Steering Committee is of the view that when a controlling entity transfers assets, or assumes or forgives liabilities of a controlled entity, or permits another entity to make such a transfer and be designated as such, that flow of resources may have the character of a “contribution from owners”. For an inflow of resources to be recognized as a “contribution from owners” in the public sector, the Steering Committee is of the view that it must be evidenced by any of the following:
- (a) formal designation of the transfer (or a class of such transfers) by the transferor or a controlling entity of the transferor as forming part of the transferee’s net assets/equity, either before the transfer occurs or at the time of the transfer;
  - (b) a formal agreement, in relation to the transfer, establishing a financial interest in the net assets of the transferee which can be sold, transferred or redeemed; or
  - (c) the issuance, in relation to the transfer, of equity instruments which can be sold, transferred or redeemed.<sup>1</sup>
- 2.28. The absence of any evidence of the designation of an inflow of resources as a “contribution from owners” means that the inflow cannot be recognized as a “contribution from owners”, and must be recognized either as a liability or as revenue, or a combination thereof. The Steering committee is, however, of the view that the definition of “contributions from owners” is not responsive to the public sector environment and advocates that it be reviewed.

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<sup>1</sup> Based on Australian Accounting Standards Board, (January 2001) Abstract 38: Contributions by Owners made to Wholly-Owned Public Sector Entities, paragraph 7.

## **F. Has the Entity Satisfied Any Outstanding Obligations Related to the Inflow?**

- 2.29. When an entity recognizes an asset, or reduces the carrying amount of an already recognized liability, it may also be required to recognize a liability in respect of that inflow of resources. For example, a grant may specify the provision of services to third parties. As an entity satisfies the obligations relating to the inflow of resources, it may be able to reduce the carrying amount of any liability recognized, in which case it may be able to recognize revenue. This section discusses the definition and criteria for recognition of liabilities. Chapter 3 on Stipulations further expands on particular circumstances which require the recognition of liabilities in relation to the inflow of resources from non-exchange transactions.

### **Definition of Liabilities**

- 2.30. IPSAS 1, paragraph 6, states that:

***Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.***

Paragraphs 3.32 to 3.34 explain key aspects of this definition. Where an entity has previously recognized liabilities, it will review those liabilities to determine whether they still meet this definition (and the recognition criteria below) and if they do not, the liabilities would no longer be recognized. For example, if an entity has settled liabilities by sacrificing assets, then there is a reduction in both assets and liabilities, and no change to net assets, therefore no revenue.

### Present Obligation

- 2.31. Paragraph 24 of IPSAS 19 states that in most cases it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a dispute relating to the breach of a grant agreement, it may be disputed either whether certain events have occurred or whether those events result in a present obligation to sacrifice resources. In such cases, an entity determines whether a present obligation exists at the reporting date by taking account of all available evidence, including, for

example, the opinion of experts. The evidence considered includes any additional events after the reporting date. On the basis of such evidence:

- (a) where it is probable that a present obligation exists at the reporting date, the entity recognizes a liability (if the other recognition criteria are met); and
- (b) where it is probable that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying future economic benefits or service potential is remote.

#### Past Event

2.32. A past event that leads to a present obligation is called an obligating event. IPSAS 19, paragraph 25 states that for an event to be an obligating event, it is necessary that the entity have no realistic alternative to settling the obligation created by the event. This is the case only:

- (a) where the settlement of the obligation can be enforced by law; or
- (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

2.33. Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. IPSAS 19, paragraph 26 states, therefore, that no liability is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognized in an entity's statement of financial position are those that exist at the reporting date.

#### **Criteria for recognition as a liability**

2.34. IPSAS 19, paragraph 22 establishes recognition criteria for liabilities. A liability is recognized when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;

- (b) it is probable that an outflow of resources embodying future economic benefits or service potential will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no liability should be recognized. If a previously recognized liability no longer meets these criteria it should be derecognized.

Probable Outflow of Resources Embodying Future Economic Benefits or Service Potential

- 2.35. For a liability to qualify for recognition, IPSAS 19, paragraph 31 states that there must be not only a present obligation but also the probability of an outflow of resources embodying future economic benefits or service potential to settle that obligation. Where it is not probable that a present obligation exists, an entity may need to consider disclosing a contingent liability in accordance with the provisions of IPSAS 19, unless the possibility of an outflow of resources embodying future economic benefits or service potential is remote. This issue is explored further in Chapter 3 – Stipulations.

Reliable Estimate of the Obligation

- 2.36. In many cases, an entity will know the exact timing and amount of the probable outflow of future economic benefits or service potential and will recognize the liability at this amount. These amounts may be set out in grant agreements, loan agreements, other debt instruments, or in legislation. Where the time value of money is material, the entity will also need to determine the present value of the obligation. Where the liability is a provision, the entity will need to estimate the amount of the liability, in accordance with the requirements of IPSAS 19.

**G. Recognition and Measurement of Revenue from Non-Exchange Transactions**

- 2.37. When an increase in net assets arises from a non-exchange transaction that does not result from a properly designated and documented contribution from owners, that increase in net assets should be recognized as revenue.

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- 2.38. Revenue should be measured at the fair value of the increase in net assets. An inflow of inventory is measured at the cost of the inventory. Inflows of investment property and property, plant and equipment should also be measured at the cost of the asset, however, if there is no cost or a nominal cost, cost is the fair value as at the date of acquisition. Inflows of other assets should be measured at the fair value of the asset as at the date of acquisition. Where the inflow relates to the reduction in the carrying amount of liabilities, the inflow is measured at the reduction in the carrying amount of liabilities. Where there is a compound transaction, the increase in net assets is calculated as the increase in assets, less any increase in liabilities.
- 2.39. Where the carrying amount of an asset is remeasured subsequent to initial recognition, that remeasurement does not affect the amount of revenue initially recognized in respect of that asset, even if the remeasurement occurs in the same reporting period. Events subsequent to initial recognition that require the remeasurement of an asset's carrying amount are separate events that should be recognized separately in the financial statements. For example,
- (a) if an entity recognized revenue in respect of a donated item of property, plant and equipment, which was subsequently destroyed by fire, the revenue recognized when the entity gained control of the donation would not be revised, but an expense would be recognized in relation to the fire;
  - (b) if an entity recognized revenue in respect of a donation of an item of property, which is part of a class of assets that is subsequently revalued, the revaluation would be treated in accordance with the provisions of IPSAS 17. IPSAS 17 requires that an increase should be credited directly to revaluation surplus. A revaluation increase should be recognized as revenue only to the extent that it reverses a revaluation decrease of the same class of assets previously recognized as an expense; or
  - (c) if an entity recognizes revenue in respect of a receivable, for example a tax receivable, which is subsequently identified as uncollectable, the entity does not adjust revenue, but recognizes an expense for the bad debt.



## **Presentation of Revenue**

- 2.40. IPSAS 1 requires that assets and liabilities, and revenues and expenses, not be set off against each other unless a provision in an IPSAS specifically permits such a set off. The Steering Committee is of the view that, where items meet the definition of an asset, liability, contribution from owners, revenue or expense, they should be presented separately in the general-purpose financial statements and that no netting off should occur. However, in certain circumstances additional information may be required to be presented in the notes to the general-purpose financial statements such that the relationship between various items in the general-purpose financial statements is clarified. For example, if certain social policy obligations are settled through the taxation system, this should be disclosed in the notes.

## **Preliminary Views**

1. *An inflow of economic benefits or service potential, other than a “contribution from owners”, that results in an increase in net assets should be recognized as revenue.*
2. *Revenue should be measured at the amount of the increase in net assets.*

## Chapter 3 Stipulations

- 3.1. This chapter examines the effects stipulations on the use of resources have upon the recognition of inflows of resources as revenue. In particular, the Steering Committee sought to determine if and when inflows with stipulations should be recognized as liabilities, and how such liabilities are discharged. In paragraph 1.29 it was noted that IAS 41 *Agriculture* requires reporting entities to recognize conditional grants as revenue when the conditions have been fulfilled. The same approach is adopted by the *Government Finance Statistics Manual 2001* (GFSM 2001) issued by the International Monetary Fund (IMF). The Steering Committee considered this approach as noted below, however it has also considered other approaches.
- 3.2. In many cases, funds transferred to public sector entities in a non-exchange transaction are subject to stipulations that they be used for particular purposes and/or within particular time periods. This is frequently the case for grants and other transfers or contributions from:
- (a) national governments to provincial/state or local governments; and
  - (b) governments to governmental entities that are created by legislation or statute to perform specific tasks with operational autonomy, such as statutory authorities or regional boards or authorities.

Transfers of physical assets may also be subject to stipulations regarding the nature or timing of their use. Unless specified otherwise, the term “transfer” is used in the remainder of this section to encompass grants, contributions, and other transfers of funds or other assets to public sector entities in a non-exchange transaction.

- 3.3. In addition to authorizing the purposes and time periods for which the transferred resources may be used and/or the circumstances under which their use is authorized, stipulations may also identify the consequences, if any, of non-compliance with the terms under which such transfers are made. In some cases, stipulations will specify that assets be returned to the grantor if they are not deployed as prescribed. For example, funds or other assets may be transferred to the recipient entity:

- (a) prior to the time period during which their use is authorized, including funding provided to support the provision of services for a number of time periods – such as multi-period grants from a national government to support particular state or local government programs or government universities or research institutes;
  - (b) subject to the stipulation that they are only to be used by the recipient for the purposes specified and/or are only to be used if another specified event occurs – such as a matching contribution from a third party or a commitment by the recipient to also devote an agreed amount to the activity; or
  - (c) on an expenditure reimbursement basis, such that funding will only be provided when the authorized expenditure occurs and appropriate documentation is provided.
- 3.4. This ITC uses the term *stipulations* to encompass the terms and conditions that are imposed on the use of funds or other assets transferred to the reporting entity by external parties. Stipulations often require a specific action or event to occur before the reporting entity is authorized to use the funds or other assets. To satisfy the meaning of stipulations as used in this ITC, the terms and conditions will need to be reflected in:
- (a) explicit agreements with the external parties who transfer the funds or other assets to the recipient, or
  - (b) legislation enacted by the transferor government, where funds or other assets are transferred to the reporting entity by another government or government entity.

This means that stipulations can never be self-imposed by the entity receiving the transferred resources.

#### **Differing Views on the Treatment of Transfers subject to Stipulations**

- 3.5. Some are of the view that the distinction between restrictions and conditions as outlined below is critical to the assessment of when revenue should be recognized:
- (a) **restrictions** which limit or direct the use of contributed funds or other asset, whether as to the purposes for which

they may be used or the time period(s) during which they may be used, but which do not specify that the asset is to be returned if not deployed as specified; and

- (b) **conditions** which specify that the transferor has a right of return of the funds or other assets if they are not deployed as specified, or if a specified future event does not (or does) occur.

3.6. Those that distinguish between restrictions and conditions as outlined in paragraph 3.4 argue that a present obligation may arise when the recipient gains control of a transfer which is subject to a condition, but will not arise in respect of transfers that are subject to a restriction. Accordingly, they argue that if the recognition criteria are satisfied, transfers other than contributions from owners, should be recognized as revenue:

- (a) immediately the recipient gains control of transfers which are subject to restrictions – because the gaining of control of the assets increases the net assets of the entity; and
- (b) in respect of transfers subject to conditions, only when those conditions are satisfied – because gaining control of the assets also gives rise to a liability to return the assets if the conditions are not satisfied. Consequently, it is only when those conditions are satisfied that the liability is discharged, that the net assets of the entity are increased and revenue should be recognized.

3.7. Others argue, “For a condition to arise, some specified discrete future event (a trigger event) that is additional to the actual use of the asset must occur or fail to occur.”<sup>1</sup> They are of the view that this additional “trigger” is necessary to distinguish restrictions from conditions.

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<sup>1</sup>Westwood, Mark and April Mackenzie, (1999): Accounting by Recipients for Non-Reciprocal Transfers, Excluding Contributions by Owners: Their Definition, Recognition and Measurement, Australian Accounting Standards Board, Canadian Accounting Standards Board, International Accounting Standards Committee, New Zealand Financial Reporting Standards Board, United Kingdom Accounting Standards Board, United States Financial Accounting Standards Board (G4+1), paragraph 4.18.

- 3.8. Still others are of the view that when the recipient gains control of the transferred assets, and it is not probable that the stipulations will be breached, the amount of those assets should be recognized as revenue notwithstanding any stipulations regarding their use, unless the transfer has been by way of a contribution from owners. Therefore, revenue is recognized and a contingent liability is disclosed, unless the possibility of a breach of stipulations is remote, in which case no disclosure is required. They argue that all assets provided to public sector entities are subject to terms and conditions that they be used appropriately. However, those terms and conditions do not give rise to a liability until such time as they are breached and a penalty is imposed on the reporting entity.
- 3.9. Finally, others are of the view that transfers which are subject to stipulations should not be recognized as revenue until such time as the recipient has discharged the terms and conditions specified by those stipulations. Supporters of this view argue that the recipient has an obligation to discharge those terms and conditions and only increases net assets and therefore recognizes revenue as those terms and conditions are discharged.

#### **The Approach adopted in this ITC**

- 3.10. This ITC defines revenue in terms of the increase in net assets, other than increases resulting from a contribution from owners. Revenue will be recognized when the entity gains control of assets or reduces the carrying amount of liabilities and does not at the same time recognize an increase in liabilities and/or a contribution from owners (whether separately or in combination) of an equivalent amount. The diagram in paragraph 2.3 identifies in schematic form the steps involved in determining when revenue is to be recognized.
- 3.11. Consistent with this approach, determining whether transfers that are subject to stipulations should be recognized as assets, liabilities, contributions from owners and/or revenue involves consideration of the following key elements of the definition and recognition criteria of assets and liabilities:
- (a) does the recipient control an asset which is subject to stipulations;

- (b) does the transfer constitute a contribution from owners;
- (c) does gaining control of the asset give rise to a present obligation to transfer cash or other assets to third parties that should be recognized as a liability; and if yes
- (d) when and how is the liability settled.

These matters are considered further below.

**Does the recipient control an asset which is subject to stipulations?**

- 3.12. Paragraph 1.18 proposes that “control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or regulate the access of others to that benefit”.
- 3.13. It may be argued that funds transferred to entities subject to conditions that they be used in particular ways and returned to the transferor or otherwise forfeited if not so deployed are not controlled by the recipient. This is particularly so where those conditions specify that the funds are to be transferred to third parties or otherwise provide the recipient with little discretion in the use of those funds. In these circumstances, it may be argued that the recipient is acting in the capacity of an agent in respect of those funds.
- 3.14. The Steering Committee is of the view that funds deposited in a bank account controlled by the recipient will be controlled by the entity. This is because the recipient can benefit from the use of those funds whether through the interest they generate or their deployment as specified in the stipulation. In these circumstances, the recognition criteria will be satisfied because future economic benefits or service potential will flow to the entity and the amount of the transfer can be measured reliably. This view is consistent with that adopted for “control of cash” in the *Cash Basis IPSAS Financial Reporting Under the Cash Basis of Accounting*.
- 3.15. Judgment will need to be exercised in determining when control of other assets, including non-monetary assets such as property, plant and equipment, arises. In most cases, control will arise when the recipient assumes the authority to deploy the asset in achieving its objectives, within the parameters established by

any stipulations. When this occurs, the entity will benefit from the future economic benefits or service potential represented by the asset because it can use that asset in achieving its organizational objectives. If the value of the asset can be reliably determined at this time (measurement is dealt with in paragraphs 2.21 – 2.23), the asset recognition criteria will be met.

- 3.16. Determining whether or not revenue should be recognized when the recipient gains control of the transferred assets will involve consideration of whether:
- (a) the transfer is in the nature of a contribution from owners. Paragraph 2.27 above deals with the circumstances in which a transfer will qualify as a contribution from owners; or
  - (b) gaining control of the transferred assets gives rise to a present obligation which is expected to result in an outflow of resources from the entity, and in respect of which the entity has no realistic alternative but to settle that obligation. If this is the case a liability rather than revenue will be recognized.

**Does gaining control of the asset give rise to a liability?**

- 3.17. IPSAS 19 paragraphs 24 to 28 explain that:
- (a) an obligation and therefore a liability always involves the transfer of resources to another party. However, it is not necessary to know the identity of the other party – for example, the obligation to transfer assets may be to the public at large;
  - (b) for a liability to arise, the obligation must have arisen from a past event and the entity must have no realistic alternative but to settle the obligation. In applying this guidance to stipulations to non-exchange transactions it means that a liability can only arise in respect of an externally imposed condition. Internally imposed conditions will not give rise to a liability because the entity can avoid the need to transfer resources to another party by itself removing the condition; and

- (c) a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is probable that a present obligation exists at reporting date.

Consequently, for a liability to arise at the time the entity gains control of an asset, the stipulations associated with the transfer must give rise to a present obligation for the recipient to transfer resources to another party, and the recipient must have no realistic alternative but to make that transfer.

#### Restrictions

- 3.18. The Steering Committee is of the view that a present obligation does not arise at the time an entity gains control of an asset which is subject to restrictions which:

- (a) specify or limit the use of that asset; but
- (b) do not require the asset to be returned to the transferor if the asset is not deployed as specified, or if other restrictions on or terms governing its use are not met.

In these circumstances, at the time the entity gains control of the asset there is not a present obligation to transfer future economic benefits or service potential to another party. However, a present obligation to transfer those assets to third parties, whether the ultimate recipient of the goods or services or the service provider, may arise at a later date as a result of subsequent transactions or events.

#### Conditions

##### *Assets to be Transferred Directly to Third Parties*

- 3.19. The Steering Committee is of the view that, in respect of transfers other than contributions from owners, gaining control of funds or other assets that are subject to stipulations which require the recipient entity to transfer the assets to third parties or otherwise return the assets to the transferor, will give rise to a liability. This is because, as a result of gaining control of the funds or other assets (the obligating event), the recipient has no realistic alternative but to transfer to those funds or other assets:

- (a) to third parties in accordance with the conditions related to the provision of the assets by the transferor; or

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- (b) to return them to the transferor if the conditions are breached.

*Assets to be Consumed in Providing Goods and Services*

3.20. The Steering Committee considered whether conditions that funds or other assets be deployed in the provision of goods or services as specified or be returned to the transferor would also give rise to a liability when the recipient gains control of such conditional assets. The Steering Committee is of the view that different conclusions can be reached in respect of funds and other assets in these circumstances. The Steering Committee is of the view that gaining control of funds subject to such stipulations gives rise to a present obligation to sacrifice resources as the recipient is required to either:

- (a) contract with other parties, whether employees or others for the acquisition of goods and services which are to be transferred to the ultimate recipients; or
- (b) return the funds to the transferor.

In these cases, gaining control of the funds will give rise to a liability of similar amount because the entity has no realistic alternative but to sacrifice resources to another party. Accordingly, an increase in net assets will not arise until the liability is settled, at which time revenue will be recognized.

3.21. The Steering Committee noted views that:

- (a) there is no substantive difference between the future economic benefits or service potential represented by monetary assets or other assets, in particular property, plant and equipment; and
- (b) gaining control of depreciable assets<sup>1</sup> that are transferred subject to such stipulations will also give rise to a present obligation to:

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<sup>1</sup> Those that support this view recognize that land and other non-depreciable assets will not be consumed in providing goods and services to third parties. However, they note that where such assets are provided for a specified period of time and are to be returned to the transferor at the completion of that period of time, the recipient gains control of a finite quantum of service potential and, subject to the stipulations attached to the transfer, is Item 9.3 *Draft Invitation to Comment Revenue from Non-Exchange Transactions (including Taxes, Transfers and Grants)*  
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- (i) transfer resources to third parties as the non-monetary assets are consumed in generating services for, or in producing goods that will be transferred to, third parties in accordance with the stipulations; or
  - (ii) returned to the transferor where those stipulations are breached.
- 3.22. The Steering Committee agrees that there is no substantive difference between the future economic benefits or service potential represented by funds or that represented by other assets. However the Steering Committee is of the view that gaining control of a non-monetary asset in these circumstances and subject to such stipulations would not give rise to a present obligation to sacrifice resources to third parties. While the recipient may use the asset and consume its service potential, it will in effect transform the asset into a different resource (whether goods or services) controlled by the recipient. A present obligation would only then arise when the recipient was required to transfer those final goods or services to third parties as a consequence of subsequent transactions or events, or when the stipulations were breached and the asset was required to be returned to the transferor. As such, the gaining of control of the asset is not an obligating event because it does not give rise to the entity having no realistic alternative to transferring resources to another party, whether the transferor or a third party. Rather it is a subsequent event that is the obligating event. The Steering Committee also noted that conditions generally relate to the expenditure of funds. As such, liabilities recognized in respect of those conditions are discharged, and the net assets of the entity are increased when conditions relating to the acquisition of capital assets, rather than conditions relating to the use of those assets, are satisfied.

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obligated to transfer that service potential to third parties. In these cases, an asset and a liability will be recognized for the service potential the recipient gains control over as a consequence of the transfer, and revenue will be recognized as the conditions are satisfied. Where there is no obligation to return the assets to the transferor after a specified period of time, the recipient will recognize an increase in an asset, without any concomitant increase in a liability when it gains control of the asset.

*Transfers Subject to “Matching” Contributions*

- 3.23. The Steering Committee is also of the view that assets that are transferred for use subject to conditions that, for example:
- (a) a matching contribution is made by the recipient or another party; and;
  - (b) if no such contribution is made, the assets are to be returned to the provider.
- 3.24. The Steering Committee noted that there were two possible assumptions that entities could make in relation to “matching” contributions:
- (a) it is probable that a matching contribution will be made or
  - (b) it cannot be determined whether or not a matching contribution will be made.
- 3.25. If it is assumed that a matching contribution will be made, the entity will not recognize a liability in relation to the inflow of resources because it is not probable that the entity will have to return the initial contribution to the transferor, the entity will therefore recognize revenue immediately in respect of that initial transfer.
- 3.26. If it is assumed that the entity cannot determine whether or not a matching contribution will be made, the initial transfer will give rise to a liability which will be discharged when the matching contributions are made or it becomes clear that they will be made. It is not until this point in time that the present obligation to return the asset to the transferor is discharged.
- 3.27. The Steering Committee is of the view that until it becomes clear that the matching contribution will be made, an assessment of all available evidence will lead one to conclude it is probable that a present obligation to return the asset exists.

**When and how is the liability settled?**

- 3.28. When the conditions are satisfied, the carrying amount of the liability will be reduced and revenue will be recognized. The timing of recognition of revenue will then be determined by the nature of the terms and conditions and their settlement, for

example where a liability is recognized when funds or other assets are provided on condition that they:

- (a) are used to deliver goods and services as specified and are to be returned to the provider if not deployed as specified – the liability will be discharged as those goods and services are provided;
- (b) be expended in the acquisition of capital assets and are to be returned to the provider if not deployed as specified – the liability will be discharged when the capital assets are acquired;
- (c) only be used for the purposes specified if a matching contribution is made by the recipient or another party and are to be returned to the provider if such a contribution is not made – the liability will be discharged when the matching contributions are made or it becomes clear that they will be made; and
- (d) in the case of funds provided on the condition that they be invested to form a permanent endowment and are to be returned if such an endowment is not established – the liability will be discharged when those funds are invested consistent with the conditions imposed by the transferor.

In each of these cases, as a result of the actions or events identified above, it will no longer be probable that the recipient will need to transfer resources to another party as a result of a present obligation which arose when the entity gained control of the assets which were subject to the stipulations.

3.29. The Steering Committee is concerned to ensure that the mere form of a transfer subject to stipulations, rather than the substance of the transfer, does not inappropriately dictate accounting for such transfers. The mere inclusion of a condition in a stipulation is in itself not sufficient for a liability to be recognized when the entity gains control of the asset. To qualify for recognition as a liability an outflow of resources must be probable. The Steering Committee is of the view that for this to occur:

- (a) in respect of stipulations relating to the provision of goods or services or the acquisition of assets – the stipulations will need to specify such matters as: the nature and

quantum of the goods and services to be provided; the nature of assets to be acquired; the location and characteristics of the recipients of any goods and services; and the periods within which the provision of goods and services is to occur. In addition, delivery of services will need to be monitored by/on behalf of the provider on an ongoing basis and if significant failure to deliver has occurred in the past, the right of return of the asset has been exercised or some equivalent penalty imposed. The Steering Committee is of the view that these characteristics of stipulations and the related follow-up actions are necessary to ensure that the specification of conditions is not simply a matter of form, but substantively satisfies the definition and recognition criteria of a liability;

- (b) in respect of transfers that are conditional on a subsequent event occurring, such as the raising of a matching contribution – the possibility that the condition will not be met must be remote, and if failure to satisfy the condition has occurred in the past, the right of return of the asset has been exercised. It is only in these circumstances that the gaining of control of the asset subject to these “conditional promises” is likely to give rise to a present obligation for which an outflow of resources is probable.

### **Special Cases – Time Requirements**

3.30. In the public sector, transfers are frequently made subject to their use in particular time periods. The Steering Committee notes that there are two alternative approaches to accounting for such transfers:

- (a) recognize an asset and revenue immediately the entity obtains control of the asset; and
- (b) recognize the asset and a liability, and amortize the liability and recognize revenue in the period in which the asset’s use is authorized.

3.31. The Steering Committee notes that those who support option (a) are of the view that funds transferred subject to stipulations regarding the timing of their use, do not normally specify that the amounts are to be returned to the provider if they are consumed other than in the prescribed periods, and therefore will not give rise to liabilities when the entity gains control of them.

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This is because at that time the recipient gains control of the funds a present obligation to transfer those funds to a third party or to return them to the transferor does not arise.

- 3.32. However, the Steering Committee also notes that in many cases in the public sector, time restrictions are imposed on the recipients of transfers such that the recipient is unable to discharge its obligation to use funds in a particular way until the commencement of the nominated period. The Steering Committee is concerned that the application of the definitions of assets and liabilities to transfers subject to time requirements will result in revenue being recognized when funds are received prior to commencement of the period during which its expenditure is authorized.
- 3.33. The Steering Committee notes that when services are prepaid in an exchange relationship a liability is recognized. This is the case in circumstances such as, for example, the prepayment of tuition fees of students at a private school for a specified period by a benefactor. In these circumstances, the recipient will recognize a liability for the amount of the prepayment, and revenue is recognized as the service is provided. Similarly, if a government provides funds in advance to support the operating budget of that private school for a specified future period, subject to the school providing educational services to a specified number of students, a liability would be recognized for the prepayment. The recognition of the liability would reflect that the school has a present obligation in respect of the group of students nominated by the benefactor or the government. The Steering Committee is concerned that in similar circumstances, the funding in advance of the operation of a government school by the same benefactor or the same external government will not be recognized as a prepayment because a present obligation to transfer future economic benefits or service potential to third parties does not arise as a result of the entity gaining control of those funds. Rather a present obligation only arises when services are provided by teachers and the entity is obligated to use the contributed funds as payment.
- 3.34. The Steering Committee considered whether the substance of the arrangement was that the entity does not gain control of the service potential represented by funding until the commencement of the period in which expenditure of the cash is

authorized. While an appealing notion, the Steering Committee concluded that this does not reflect reality when the cash is held in a bank account controlled by the entity.

- 3.35. The Steering committee notes that IAS 41 *Agriculture* specifies that a government grant related to a biological asset measured at fair value should be recognized as income when and only when the conditions attaching to that grant are met. (IAS41 paragraph 35). IAS41 also notes that in some circumstances a multi-period government grant, may:

- (a) require an entity to farm in a particular location for five years or return the grant to the grantor; and
- (b) allows the entity to retain part of the grant based on the passage of time.

In these circumstances the enterprise recognizes the government grant on a time proportion basis.

- 3.36. The Steering Committee is of the view that the principles adopted in IAS 41 should be applied in respect of amounts transferred to a recipient prior to the time period during which the use is authorized, including amounts transferred to fund operations for a number of periods. In these cases, the arrangement should be deemed as giving rise to a present obligation to transfer funds in the future. The Steering Committee is of the view that this better reflects the substance of these funding arrangements, and the financial statements of the recipient should reflect that the entity has an obligation to transfer resources to third parties consistent with the period for which use of the funds has been authorized by the transferor.

### **Preliminary View**

3. *Assets transferred to a recipient which are subject to stipulations should:*
- (a) *in respect of restrictions other than time restrictions, be recognized as revenue when the recipient gains control of the asset;*
  - (b) *in respect of conditions which give rise to a liability, be recognized as revenue when the recipient satisfies those conditions and the liability is extinguished; and*

- (c) *in respect of time restrictions, be recognized as revenue in the period in which their use is authorized.*



## Chapter 4 Taxes

- 4.1. Taxes are the major source of revenue for many governments. Taxes are compulsory transfers to the government, but exclude payments such as penalties, and social contributions. Non-compulsory transfers to public sector entities, such as donations and payment of fees are not taxes, although they may be the result of non-exchange transactions. A government levies taxation on individuals and other entities, known as taxpayers, within its jurisdiction by use of its sovereign powers. Under the approach proposed in this ITC, entities would analyze taxation transactions to determine firstly if they meet the definition of a “non-exchange” transaction and secondly if it is probable that they will result in an inflow of economic benefits or service potential that results in an increase in assets, or a decrease in liabilities. Taxpayers are compelled by law to transfer resources embodying future economic benefits or service potential to the government without directly receiving approximately equal value (in the form of goods or services) from the government in return. As such taxes are non-exchange transactions.
- 4.2. Assets flowing to the entity must satisfy the criteria for recognition of an asset, that is it must be probable that the inflow of economic benefits or service potential will occur, and has a fair value that can be measured reliably. The assets that flow to the entity include cash or the right to receive cash. For example, if a taxpayer has incurred an obligation to pay tax, the government has the right to receive that tax, even if the process of assessing the exact amount of that tax has not been undertaken yet. Notwithstanding the government’s right to receive taxes, it must be able to reliably measure those tax assets before they can be recognized, which may not be possible until some time after the tax accrues to the government.
- 4.3. Taxes result in an inflow of future economic benefits or service potential to the government, as stated above. This inflow does not result in the government incurring a liability to provide either goods or services directly to the taxpayer in exchange for the resources. Nor do taxes result in the taxpayer acquiring a financial interest in the net assets/equity of the government in accordance with paragraphs 2.24 to 2.28 above. Taxes are therefore, revenue from non-exchange transactions.

- 4.4. Tax laws vary enormously from jurisdiction to jurisdiction, but they do have a number of common characteristics. Tax laws establish a government's right to collect the tax, identify the basis on which tax is calculated, and establish procedures to administer the tax, that is procedures to calculate the tax receivable and ensure payment is received. Tax laws often require taxpayers to file periodic returns to the government agency that administers a particular tax. The taxpayer provides details and evidence of the level of activity attracting tax and the amount of tax receivable by the government is calculated. Arrangements for receipt of taxes vary widely but are normally designed to ensure that the government receives payments on a regular basis without resorting to legal action. Tax laws are usually rigorously enforced and often impose severe penalties on individuals or entities that breach the law.

### General Issues

#### *Tax Expenditures and Social Policy Obligations Settled Through the Taxation System*

- 4.5. The Steering Committee has made a distinction between tax expenditures and expenses that are paid through the tax system. ***Tax expenditures*** are preferential provisions of the tax law that provide taxpayers with concessions that are not available to others. These concessions are provided to promote or deter particular behaviors. As noted in PSC Study 10 *Definition and Recognition of Expenses/Expenditures*, paragraph .087, tax expenditures are forgone revenue and they are not expenses.
- 4.6. ***Expenses paid through the tax system*** are items that are available to beneficiaries regardless of whether or not they pay taxes. Some beneficiaries will not receive the payment through the tax system, but will receive it in another form, for example by check or electronic payment, or a cash payment from a benefit office. Some beneficiaries will receive payment as a reduction in the amount of income tax installments withheld from their wages or salary. For example, in the United Kingdom, employees who have income tax installments withheld from their wage or salary payments receive child benefits as a reduction in those installments, whilst other eligible persons receive a cash, check or electronic payment.

- 4.7. The key distinction between tax expenditures and expenses paid through the tax system is that the benefit is available to entities irrespective of whether they pay taxes, or use a particular mechanism to pay their taxes. The Steering Committee is of the view that where such a benefit is paid through the tax system, revenue should be increased by the amount of the expense and an expense recognized for the same amount.

*The Tax Gap*

- 4.8. For many taxes, the reporting entity will be aware that the actual amount that the government is entitled to collect under the tax law is higher, in many cases materially higher, than the amount that will actually be collected. The amount collected is lower due to fraud, error and bad debts. The difference between what is legally due under the law, and what the government will be able to collect is referred to as the **tax gap**. An entity may disclose information about the tax gap in the notes to its general-purpose financial statements in order to provide information on the ability of the entity to enforce the tax law. However, the tax gap does not meet the definition of an asset and therefore should not be recognized as revenue and an expense. The tax assets and revenue recognized will be those assets and revenues that meet the applicable definitions and satisfy the criteria for recognition.

**Recognition of Tax Assets, Liabilities and Revenue**

- 4.9. In order to recognize assets, liabilities and revenue, reporting entities must determine when a “past event” has occurred, when control of resources passes to the reporting entity, whether it is probable that an inflow of resources has occurred, and whether it is possible to reliably measure that inflow.

*Past Event – Taxable Event*

- 4.10. Taxable events give rise to assets, liabilities and revenue, which, under accrual accounting principles, should be recognized when the **taxable event** occurs. The taxable event is the past event that the government, legislature, or other authority has determined will be subject to taxation. However, in many circumstances recognition of the assets and revenue will be delayed because the reporting entity is unable to determine whether it is probable

that an inflow of resources will occur, or it is unable to reliably measure the inflow. The criteria for recognition of an asset may not be met until the entity formally assesses the taxes, or in some circumstances until cash is received by the entity.

4.11. The following examples indicate the preliminary views of the Steering Committee on when the taxable event occurs for certain types of taxes, and hence the earliest point at which tax assets, and revenue which satisfy the recognition criteria can be recognized:

- (a) *income taxes*: the taxable event is the earning of income during the taxation period, ideally tax assets and revenue would be recognized as income is earned;
- (b) *value added taxes*: the taxable event is the undertaking of taxable activity during the taxation period, ideally tax assets and revenue would be recognized as value is added by the taxpayer;
- (c) *goods and services taxes*: the taxable event is the purchase or sale of taxable goods and services during the taxation period, ideally revenue should be recognized when the purchases and sales take place;
- (d) *customs duties*: the taxable event is the movement of dutiable goods or services across the customs boundary, ideally revenue should be recognized when the goods enter the jurisdiction;
- (e) *death duties*: the taxable event is the death of a person owning taxable property, ideally tax assets and revenue would be recognize at the time the person died; and
- (f) *property taxes*: the taxable event is the passing of the date on which taxes are levied, revenue should be recognized on that date.

#### *Control*

4.12. The definition of “control of an asset” states that for an asset to be controlled the entity must be able to benefit from the asset and exclude or regulate the access of others to that benefit. In the case of assets arising from taxation transactions, control arises when the taxable event has occurred, because after that point the taxing government can enforce its right to collect a

specific amount of tax from a taxpayer. When the taxable event occurs the government is entitled to receive assets in respect of the taxable event. It will recognize this receivable as an asset and revenue when the other elements of the definition of an asset are met and the criteria for recognizing an asset are satisfied. Revenue will then be recognized as well, provided that the entity does not incur a liability in respect of the entire amount of the asset.

*Probable Inflow of Future Economic Benefits*

- 4.13. Assessing the probability of the inflow of future economic benefits is crucial to determining when to recognize assets and revenue resulting from a taxation transaction. Having identified that the entity is entitled to collect assets and revenue, the entity must make a determination as to the probability of the inflow of resources. If it is probable that resources will flow to the entity as a result of taxation transactions, then the entity would be entitled to recognize those resources as assets and revenue if the other recognition criterion is satisfied.

*Reliable Measurement*

- 4.14. Reliable measuring the assets and liabilities, and therefore the revenue, accruing to the government is a difficult problem for many governments. The nature of taxation systems is such that whilst the amount of the majority of assets and revenue are able to be reliably measured, there is a material amount that is more difficult to measure. Difficulties arise due to:
- (a) new taxpayers failing to lodge returns on a timely basis;
  - (b) the tax law allowing taxpayers a longer period to lodge returns than the government is permitted for publishing general purpose financial statements;
  - (c) difficulties in valuing taxes based on non-monetary assets;
  - (d) complexities in tax law requiring extended periods for assessing taxes due from certain taxpayers;
  - (e) the financial and political costs of rigorously enforcing the tax laws and collecting all the taxes legally due to the government may outweigh the benefits received; and

- (f) a variety of circumstances particular to individual taxes and jurisdictions.
- 4.15. The difficulties associated with reliable measurement may mean that some assets and the related revenue are not recognized until some considerable time after the taxable event occurs. In many cases the assets and revenue may be recognized in the period subsequent to the occurrence of the taxable event. However, there are exceptional circumstances where several reporting periods will pass before a taxable event results in an inflow of resources that meets the definition of an asset and satisfies the criteria for recognition as an asset.

#### *Liabilities Related to Taxes*

- 4.16. The liabilities that can arise with respect to the inflow of resources resulting from tax transactions are, principally, the liability for refunds of overpaid taxes. These occur when those entities responsible for making installment payments of taxation overestimate a taxpayer's obligation to pay tax. At the end of the taxation period, the taxing authority and the taxpayer calculate the amount a taxpayer is due to pay, and if installments made during the period exceed the taxpayer's obligations, then the difference is refunded to the taxpayer.
- 4.17. In some jurisdictions, some taxes are set aside or "earmarked" for specified expenditure. In determining whether such earmarked taxes require the entity to recognize a liability in respect of these taxes, entities would refer to the previous chapter on stipulations and to IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

#### **Recognition and Measurement of Tax Revenue**

- 4.18. Some would argue that because it is difficult to reliably measure some taxes on an accruals basis, taxation revenue should be recognized and measured on the basis of cash received. This basis is not consistent with the principles outlined in this ITC for application of the accrual basis of accounting. The principles outlined in this ITC propose that revenue be recognized in the period in which the associated increase in assets or decrease in liabilities (that does not give rise to associated increases in liabilities or decreases in assets, and that is not a contribution by

owners) is recognized subject to the recognition criteria. Cash receipts during the reporting period may not relate to the taxes payable in respect of that period, they may relate to a prior period, or indeed a later period. Some cash receipts may eventually have to be returned to taxpayers if their tax has been overestimated for that period.

- 4.19. Others would argue that tax revenue should be recognized when the taxpayers file their annual return and the taxing authority makes an assessment of the taxpayers' obligations. This argument assumes that the taxing government has no entitlement to receive the taxes until the assessment has been made. As was indicated above, in most jurisdictions a government will normally ensure that it is entitled to receive taxes regardless of whether a taxpayer files a return. Recognizing tax revenue when the assessments of tax are made will inevitably delay the recognition of revenue beyond the period to which the tax relates, which is contrary to the principles laid out in Chapter 2.
- 4.20. As was noted above it is often difficult to reliably measure taxation revenue, particularly if a tax base is volatile and estimation is not possible. In some cases delaying recognition until assessments are made will be necessary because it is impossible to reliably measure taxation revenue until that time. In other cases revenue may not be recognized until cash is received, because prior to that time, the item either does not meet the definition of an assets, or does not satisfy the criteria for recognition as an asset.

#### *Presentation of Tax Revenue*

- 4.21. Some are of the view that under some circumstances a reporting entity may wish to present tax revenue net of certain expenses, for example net of expenses paid through the tax system, or net of expenses paid using earmarked taxes. Those of this view argue that presenting revenue in this manner shows the revenue that the government or other reporting entity has at its disposal.
- 4.22. Others are of the view that there is no characteristic of tax revenue that requires an exception to the principle established in IPSAS 1 – that items of revenue and expense should not be offset against each other. The proponents of this view argue that

whilst a reporting entity may wish to show revenue net of expenses, such a presentation does not convey sufficient information to the users of the general-purpose financial statements to enable them to make fully informed decisions. They further argue that additional information about the intended or required use of some tax revenues should be disclosed in the notes to the financial statements if such information is necessary for a proper understanding of those statements.

- 4.23. The Steering Committee is of the view that offsetting should not be permitted in respect of tax revenue and any related expenses.

#### **Preliminary Views**

4. *Taxes are non-exchange transactions and should be recognized as revenue when:*
  - (a) *the taxable event occurs, that is the past event that gives rise to the control of the resources;*
  - (b) *it is probable that the future economic benefits or service potential will flow to the entity.; and*
  - (c) *the fair value of the economic benefits or service potential flowing to the entity can be measured reliably.*
5. *Tax revenues should not be offset against expenses.*



## Chapter 5 Transfers – Including Grants and Appropriations

### Definitions

#### *Transfers*

- 5.1. A **transfer** occurs when one entity provides another entity with resources without receiving any value in return. Typically one entity passes control of an asset to another entity for no charge. This occurs frequently in the public sector, however, transfers also occur in the private sector, both in profit and not-for-profit entities. Private sector entities, whether for profit or not-for-profit, may also transfer control of assets to a public sector entity. Transfers are also referred to by particular terms, which often denote particular characteristics of the transfer, such terms include, but are not limited to:

- (a) grants;
- (b) gifts;
- (c) donations; and
- (d) bequests.

Transfers may also arise as a result of an appropriation. Appropriations and grants are discussed further in this chapter, Gifts, donations and bequests, which are relatively less common in the public sector, will be discussed in Chapter 6.

- 5.2. Transfers are not exchange transactions because the recipient entity does not provide the transferor with goods or services of approximately equal value directly in exchange for the transfer. Transfers may, or may not, be made subject to stipulations. If a transfer is subject to stipulations, the recipient entity needs to determine whether the stipulations are such that it should recognize a liability in respect of part or all of the transfer (refer to Chapter 3). If a liability is not recognized, the transfer will be recognized as revenue when it is probable that the economic benefits or service potential associated with it will flow to the entity, and can be measured reliably.

- 5.3. In some circumstances, a transaction will be called a “transfer” or a “grant” in an agreement, but will be structured such that the recipient entity will be required to perform certain services for the transferor. For example, a state government may receive a transfer from the national government to use the state court system for processing national legal matters. In such circumstances reporting entities will have to determine whether the economic substance of the agreement is that of an exchange transaction to be recognized in accordance with IPSAS 9, or a non-exchange transaction to be recognized according to the principles developed in this ITC.

#### *Appropriations*

- 5.4. ***Appropriations*** are authorizations that permit a public sector entity to spend public money. For example, a legislature may authorize the government and its controlled public sector entities to spend X billion currency units for specified purposes in a given reporting period. They result in transfers, because one public sector entity, normally the whole-of-government entity, is authorized to transfer control of resources to another, normally a controlled public sector entity. Appropriations are frequently termed “current” or “capital”, however a variety of other names may also be used.
- 5.5. Capital appropriations permit a public sector entity to spend money to acquire major assets, whilst current appropriations are for operating expenditures or any other purpose. A jurisdiction may also identify other specific purpose appropriations.
- 5.6. The appropriations framework in place in a jurisdiction is normally unique to that jurisdiction. Whilst some common characteristics can be observed in some jurisdictions, particularly those with common historical roots, there are also significant differences from jurisdiction to jurisdiction, which may affect the timing of recognition of increases in net assets and any associated revenue. In many jurisdictions, one public sector entity, such as the treasury or finance department, will authorize and process payments for all public sector expenditure. In other jurisdictions, funds will be transferred to bank accounts controlled by individual public sector entities that will then authorize and process their own payments.

- 5.7. Irrespective of any differences in the appropriations framework, the fundamental principles for the recognition of increases in assets and revenue, and other elements of the financial statements remain the same. Reporting entities must determine when a “past event” has occurred, when control of resources passes to the reporting entity, whether it is probable that an inflow of resources has occurred, and whether it is possible to reliably measure that inflow.

#### *Grants*

- 5.8. **Grants** are transfers from one entity to another. A public sector entity may receive assets in the form of grants from a variety of sources including: government, international institutions, private sector entities, other public sector entities, other levels of government and individuals. A grant agreement may be for the transfer of one asset or several assets either during one reporting period or over several reporting periods. Cash grants may be received in one reporting period or in a stream of payments over several reporting periods.
- 5.9. The term “grants” is often used to denote transfers from one level of government to another level of government. For example, a national government may provide grants to local governments that have insufficient resources to undertake all the activities required of it. The term “grant” is also frequently used to denote transfers from the government to public sector entities that have a degree of independence from the government and, as a result, are outside the appropriations framework. For example, a government may provide grants to a public sector university to fund the education of undergraduates.
- 5.10. As with all inflows of resources, the reporting entity must apply the principles in chapters 2 and 3 to determine when an inflow of resources from a grant should be recognized as an increase in net assets and corresponding revenue.

### **Recognition of Increases in Net Assets and Revenue**

#### *Past Event*

- 5.11. Determining when a transfer results in an inflow of resources will be a matter of fact. The point at which an inflow can be

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recognized as an increase in an asset, or a decrease in a liability will depend upon the circumstances facing the reporting entity. In some jurisdictions, for example, an appropriation may result in a reporting entity having an absolute right to receive the appropriated resources, whilst in others the appropriation represents an authority to expend resources up to the limit of the appropriation, and the actual acquisition or expending of resources will result in an inflow to the reporting entity.

- 5.12. For most grants the past event will be the agreeing of the terms of the grant between the transferor and transferee. However, the stipulations contained in such agreements may limit the ability of the transferee to recognize assets, and/or may require the transferee to recognize liabilities in respect of the grant. The ongoing relationship between the transferor and transferee may, in some circumstances, result in the announcement of a grant meeting the definition of, and satisfy the criteria for recognition as, an asset, this is discussed further below.

*Probability of Inflow and the Control of Assets*

- 5.13. Many transfers, particularly grants, are subject to detailed written agreements, which specify when an entity will receive resources, how those resources are to be utilized, and how the entity is to account to the donor for those resources. The reporting entity will normally be able to determine from the transfer agreement when the inflow of resources will occur and the first point at which it can recognize an increase in net assets in relation to the transfer. Some are of the view that control arises even before a transfer agreement is executed, and it may be possible for a reporting entity to recognize an increase in net assets in relation to a proposed agreement. For example, if a transferor has a long standing practice of announcing grants, and then providing those resources in accordance with a standard agreement then that announcement of the transfer may enable the entity to recognize an increase in net assets and revenue immediately the transfer is announced.
- 5.14. In other circumstances the announcement of a transfer will not result in the recognition of an increase in net assets immediately because it is not probable at that stage that the resources will flow to the entity. In some jurisdictions transfers that are announced often do not materialize because the transferor and

recipient are unable to agree to the terms of a proposed transfer agreement. In such circumstances the recipient reporting entity may be unable to recognize an increase in net assets resulting from the transfer until such time as the transferor and recipient have entered a binding agreement in relation to the transfer.

#### *Multi-Period Agreements*

- 5.15. In many jurisdictions different levels of government enter multi-year agreements for the transfer of resources, which commit one level of government providing the other with transfers over several reporting periods. These transfers are normally subject to stipulations that require the recipient to achieve stated objectives before qualifying for the next installment, or may be subject to timing requirements. In determining when the inflow of resources occurs, entities must apply the principles laid out in chapters 2 and 3 to determine the appropriate period in which transferred assets, and any associated liabilities or revenue should be recognized.

#### *Central Bank Accounts*

- 5.16. In many jurisdictions, the government will operate one bank account from which all payments are made for most or all public sector entities controlled by that government. Frequently, the department of finance/treasury manages this bank account. Individual public sector entities request the department of finance to make payments on their behalf. The department of finance then scrutinizes the request, and, if the request meets the predetermined requirements, processes the payment. The Cash Basis IPSAS, paragraph 1.2.8, states that where there is a central bank account, individual public sector entities do not control the cash in that account. Consequently, the inflow of resources to those entities will consist of the reduction of the liability to pay particular amounts, when the department of finance has settled the liability on behalf of the reporting entity.

#### *Third Party Settlements*

- 5.17. Third party settlements occur when a transferor pays costs directly rather than provide funds to the recipient reporting entity. This situation commonly occurs in the public sector when a transferor is providing aid to a public sector entity, for

example, meeting half the costs of constructing a hospital. When the transferor makes payments on behalf of the recipient, the recipient does not control the funds payment, the inflow of resources is the reduction in a liability the recipient would be otherwise required to settle.

*Reliable Measurement*

- 5.18. Where transfers are received in the form of cash, measurement is not a significant issue. However, if the law or agreement relating to the transfer is such that the transfer is recognized as an asset and liability in one period and revenue over several periods, then the time value of money may be material and reporting entities may have to discount the cash flows to ensure that the correct amount of revenue is recognized in each reporting period.
- 5.19. Where transfers are received as non-monetary assets, then the entity will need to determine the fair value of the assets being transferred. As noted in chapter 2, where property, plant and equipment and investment property is acquired at no cost or for a nominal cost, its cost is its fair value as at the date of acquisition. For example, if an international aid agency builds a hospital and transfers that hospital to a public sector entity, that entity will recognize the hospital as an asset and revenue (subject to any stipulations requiring the recognition of liabilities as identified in chapter 3) at fair value as at the date of acquisition. Fair value may be determined by reference to the cost to the transferor if that is known, or by a valuation.

**Contributions from Owners**

- 5.20. Paragraph 2.24 – 2.28 proposes that contributions from owners should be evidenced by appropriate documentation that clearly states that assets provided to an entity establish ownership rights in the entity. This requirement precludes a transfer from being recognized as a contribution from owners. However, a transfer agreement may be part of a more complex arrangement whereby the entity receives both a transfer and a contribution from owners. Reporting entities need to carefully scrutinize the terms of legislation and agreements to determine if the transaction is solely one of transfer, or whether it is more complex.

## General Issues

- 5.21. Some argue that revenue arising from transfers should be recognized when the entity receives cash or other tangible non-monetary assets as a result of the transfer. This argument does not give sufficient recognition to the provisions of the laws or agreements that cause the transfer to occur. In some cases the terms of the agreement will be such that the recognition of the assets transferred and associated revenue will occur in the same reporting period, however, in other cases recognition of an increase in net assets may occur in a reporting period prior to the receipt of cash or non-tangible assets. If there is a binding agreement to transfer assets that provides for the transferor to transfer assets at a later date, the transferee may be able to recognize a receivable in respect of that transfer prior to the receipt of cash or non-monetary tangible assets.
- 5.22. In many cases laws or transfer agreements will not give the transferee control over assets until the receipt of cash or another asset. These types of laws and transfers often specify that the transferee must meet eligibility criteria, that is satisfy certain stipulations, before assets will be transferred. In such circumstances the transferee reporting entity will analyze the agreement in light of the proposals on stipulations in chapter 3 to determine when a net increase in assets and revenue are to be recognized.

## *Presentation of Revenue*

- 5.23. When presenting revenue in the statement of financial performance, IPSAS 1 states that revenues and expenses should not be offset unless a specific IPSAS requires that they be offset. Some argue that where a transfer is made to fund a particular activity, any revenue recognized in respect of that transfer should be offset against any expenses recognized in relation to the particular activity. This argument is a form of matching, and is not supported by the principles established in this ITC. Accordingly, the Steering Committee is of the view that where a transfer results in the recognition of revenue, that revenue should not be offset against any expenses.
- 5.24. Whilst revenue from transfers should not be offset against any related expenses, the notes to the general-purpose financial

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statements should provide sufficient information for users to gain an understanding of the nature of the transfers that a reporting entity has received and how those transfers have been utilized. This requirement is implied by IPSAS 1, paragraph 122(c) which requires that the notes to the financial statements provide any additional information that is necessary for a fair presentation of the financial circumstances of the reporting entity.

- 5.25. Where stipulations are attached to the transfer of resources, users need know whether those stipulations have been complied with so that they may determine whether the entity is likely to be required to return transferred assets, or is likely to meet the eligibility requirements for future transfers. The Steering Committee is of the view that such disclosures are necessary for all material transfers.

### **Preliminary Views**

6. *Transfers, including grants and those arising from appropriations, are non-exchange transactions and should be recognized as revenue when:*
- (a) *the past event occurs, that is the past event that gives rise to the control of the resources, resulting in an increase in net assets;*
  - (b) *it is probable that the future economic benefits or service potential will flow to the entity; and*
  - (c) *the fair value of the economic benefits or service potential flowing to the entity can be measured reliably.*
7. *Revenues should not be offset against expenses.*
8. *The notes to the financial statements shall disclose the nature, purpose and uses of transferred resources, including whether any stipulations attached to those transfers have been complied with.*



## Chapter 6 – Other Revenue

### Introduction

- 6.1. For many whole-of-government reporting entities, the majority of their revenue is generated through taxes and transfers, and other classes of non-exchange transactions only generate small amounts of revenue, although in aggregate the amount is usually material. However, for many public sector entities that are controlled by the whole-of-government reporting entity, these other classes of non-exchange transactions may generate amounts of revenue that are material, either in amount or nature. This chapter discusses these other classes of revenue and presents preliminary views on when and what amounts should be recognized in the general-purpose financial statements.

### Purchase and Sales of Subsidized Goods and Services

- 6.2. The definition of “non-exchange transaction” states that non-exchange assets are those where the public sector entity either receives value without giving approximately equal value directly in return, or gives value without receiving approximately equally value directly in return. Where a public sector entity purchases or sells goods and services at prices that are less than the fair value of the goods and services purchased or sold, a non-exchange transaction takes place. Many public sector entities are directed by their governments to engage in such transactions for public policy reasons.

#### *Purchases*

- 6.3. Public sector entities may purchase goods or services at prices that do not reflect the fair value of those goods and services. Whilst the purchase of goods is not normally a revenue item, in these cases the entity has an increase in net assets because the goods or services it receives are worth more than it must sacrifice to obtain them. In these circumstances there are two alternatives available to record such transactions in the general-purpose financial statements.
- 6.4. The first alternative is to recognize the goods or services acquired at their cost price, and to disclose the subsidy, where

material, in the notes to the financial statements. This approach has the advantage of recording the exact amounts of the transaction, is verifiable, complies with IPSASs 12 and where the cost is economically significant would also comply with IPSASs 16 and 17 (refer to paragraphs 2.21 – 2.23 for a discussion on the measurement requirements of these IPSASs). The disadvantage of this approach is that the assets acquired would be recognized at less than their fair value, and the value of the subsidy to the entity would not be recognized, although it may be disclosed.

- 6.5. The second alternative, and the alternative preferred by the Steering Committee, is to recognize the goods or services acquired at their fair value and to recognize the difference between the price paid and the fair value as revenue in the statement of financial performance. The advantage of this approach is that goods and services are recognized at their fair value, and the value of the subsidy is recognized in the statement of financial performance. The disadvantage of this approach is that it requires the entity to obtain the fair value of the goods or services, which may involve some subjective analysis. This approach would also require amendments to IPSASs 12, 16 and 17, as noted in paragraphs 2.21 – 2.23.

#### *Sales*

- 6.6. It is very common in the public sector for entities to fulfill social policy obligations by selling goods or services at prices below fair value. Whilst this is normally considered an expense transaction, the fact that the entity is charging a price means that it is receiving an inflow of economic benefits in relation to that consideration. As with the purchase of goods at subsidized prices, there are two alternative approaches for recognizing these transactions in the general-purpose financial statements.
- 6.7. The first approach is to recognize the inflow at the actual amount that is received in respect of the sale and to disclose in the notes the amount of the subsidy as the difference between the fair value of the goods and services sold and the price charged for those goods and services. This approach has the advantage that it is externally verifiable and follows the approach adopted in IPSAS 9. The disadvantage of this approach is that the amount of the subsidy given is not

recognized in the statement of financial performance and does not follow the fair value approach proposed in this standard in respect of non-exchange transactions.

- 6.8. A second approach, and that preferred by the Steering Committee, is to recognize revenue for the fair value of the goods or services sold and to recognize an expense in the statement of financial performance for the difference between the fair value of the goods and services sold and the consideration received in respect of them. The advantages of this approach are that it is consistent with the fair value approach being proposed in respect of purchases of subsidized goods and it recognizes the subsidies given in the statement of financial performance. The disadvantage of this approach is that it requires entities to ascertain the fair value of the goods and services being provided, in some circumstances it will be difficult to estimate a fair value because the goods or services being provided are only available on a subsidized basis.

## **Loans**

- 6.9. In the public sector it is very common for reporting entities to borrow or lend money at interest rates that are less than the interest rates that would otherwise be available to the borrower. For example, a state government may borrow from the national government at a lower interest rate than the bond market or banks would extend to the state government. Further, a government may provide low interest housing loans to eligible low-income earners as part of a social policy program. The effect of a low interest loan is to provide a transfer from the lender to the borrower equal to the difference in the present values of loans at the subsidized rate and at the fair value rate. For example, if a provincial government borrowed 100 million currency units from the national government for ninety days at an agreed rate of 4% per annum, when the incremental short term borrowing rate for the provincial government was 6% per annum, the national government effectively provides a transfer of 499,200 currency units to the provincial government.<sup>1</sup>

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<sup>1</sup> The future value of 100 million currency units at 4% and 6%, compounding daily for 90 days is 100,991,127 and 101,490,327 respectively, the difference is 499,200.

*Borrowers*

- 6.10. Where a reporting entity borrows money in a non-exchange transaction, at an interest rate lower than its incremental borrowing rate, it receives a financial benefit from that transaction that should be recognized or at least disclosed in its general-purpose financial statements. As was illustrated in the previous paragraph that benefit can be quite substantial. In essence the borrower could be seen as borrowing less money, and receiving a transfer, in which case the benefit is derived in the period the loan is extended, or the borrower could be seen as receiving a transfer during each period of the loan for the difference between the interest that would have been payable had the borrower's incremental rate of interest been charged and the actual interest that is due under the terms of the loan. There are three alternatives for borrowers to recognize these loans.
- 6.11. The first approach is to recognize the loan according to the terms of the agreement, which is not to recognize any imputed subsidy in the loan, but to disclose the terms of the loan in the notes to the general-purpose financial statements, including the amount of the imputed subsidy. This approach has the advantage that the information is externally verifiable, and discloses the terms of the loan. This approach has the disadvantage that it does not recognize the inflow of resources to the entity as a result of obtaining a low interest loan through a non-exchange transaction.
- 6.12. The second approach is to recognize the loan principle according to the terms of the agreement, and each period recognize the interest expense at the entity's incremental borrowing rate, and to recognize in each period a transfer equal to the difference between the interest expense recognized and the interest payable to the lender. The entity would also disclose the nature of the transfer in the notes to the general-purpose financial statements. This approach assumes that the entity receives benefits from the loan in each period of the loan. The advantage of this approach is that it recognizes the imputed transfer that is received in respect of the loan. The disadvantage of this approach is that it requires entities to determine what its incremental borrowing rate is, and to impute a transfer based on that, which may be an unfamiliar practice to many preparers.

- 6.13. A third approach, and that preferred by the Steering Committee, is to recognize the principal of the loan at its fair value as at the date the loan is made, determined using the borrowing entity's incremental rate of interest. The difference between this amount and the principal amount as stated in the loan agreement should be recognized as a transfer in the period in which the loan is made. In each period of the loan, the interest expense recognized is equal to the interest payable in that period. The entity would also disclose the nature of the loan in the notes to the general-purpose financial statements. This approach assumes that the entity receives the benefits from the loan conditions in the period in which the loan is made. This approach has the advantage that the borrower recognizes the imputed transfer in the statement of financial performance when that benefit is first received. Further, by recognizing the loan at its fair value, this approach is consistent with the approach adopted in this ITC of using fair value as the primary basis of measurement for non-exchange transactions. The disadvantage of this approach is that it assumes the inflow of resources occurs only in the first period and does not continue throughout the life of the loan.

*Lenders*

- 6.14. Where a lender lends money in a non-exchange transaction it effectively transfers resources to the borrower by agreeing to a lower interest rate than the borrower's incremental borrowing rate. Whilst the transfer of resources from an entity would normally be seen as an expense and not within the scope of this ITC, the fact that the transaction generates revenue for the lender and is not within the scope of IPSAS 9, means that this ITC must consider these transactions. Entities have the same three alternatives for accounting for lending transactions that borrowers have for accounting for borrowing transactions, that is:
- (a) recognize the transaction strictly as laid out in the loan agreement;
  - (b) recognize the principal in accordance with the loan agreements and gross up interest revenue to that which would be due using the borrower's incremental borrowing

rate, and recognize an expense for the difference between the interest revenue and the interest receivable; and

- (c) recognize the fair value of the loan (the present value of the cash flows of the loan, discounted using the borrower's incremental rate of interest) as the principal, recognize the interest revenue as equal to the interest payable, and recognize the difference between the principal stated in the loan agreement and the fair value of the loan as a transfer expense in the statement of financial performance in the reporting period in which the loan is made.

Entities would make disclosures relating to the loan in the notes to the financial statements in all cases.

- 6.15. The advantages and disadvantages of are the same as laid out for borrowers. The Steering Committee is of the view that the accounting treatment of borrowers and lenders should be complementary and therefore that option (c) above is the preferred option for both borrowing and lending. Adopting the fair value as the measurement basis for assets on initial recognition is the consistent view proposed by this ITC.

*Debt Forgiveness/Assumption of Liabilities*

- 6.16. In the public sector lenders will sometimes waive their right to collect a debt owed by a public sector entity, effectively canceling the debt. For example, a national government may cancel the debt owed by a local government. In other circumstances, a public sector entity's controlling entity may assume responsibility to satisfy the controlled entity's liabilities. For example a government may assume the employee entitlement liabilities of a government department. In both cases the former debtor experiences an inflow of resources resulting in an increase in net assets, because a liability it previously owed is now extinguished. There are essentially two ways to account for such transactions. The first is to take the inflow directly to accumulated reserves so that it does not affect the reported financial performance for that period. This view assumes that these resources are similar to an injection of equity or a revaluation of the liability. However, in these circumstances there is no evidence of a contribution from owners, nor is there

evidence that the fair value of the liability had decreased prior to the canceling or assumption of the debt.

- 6.17. The second approach, and the Steering Committee's preferred approach, is to recognize a transfer for the carrying amount of the liability that was forgiven or assumed. This approach assumes that the former creditor is transferring its asset, the debt, to the former debtor and as with any transfer it should be recognized as an increase in net assets and revenue.

## **Leases**

- 6.18. IPSAS 13 *Leases* does not have a specific exclusion relating to non-exchange transactions, however, the Steering Committee is of the view that it may be assumed not to apply to non-exchange transactions. As noted in IPSAS 13 there are two types of lease, finance leases and operating leases. Finance leases are similar in nature to loans, and are recognized in a similar fashion. The Steering Committee is of the view that the discussion in paragraphs 6.9 to 6.17 applies equally to finance leases. Operating leases, however are recognized in a different manner. This section focuses only on operating leases.

## *Lessors*

- 6.19. Non-exchange operating leases are very common in the public sector. Public sector lessors frequently provide, for example, residential accommodation at rents that do not reflect the fair value rent for that property, often referred to as public housing. Whilst providing subsidized rental accommodation is normally seen as a cost to the government, it is a fact that the transactions do generate some rent revenue for the public sector lessor. There are two approaches to accounting for this rent revenue.
- 6.20. The first approach is to recognize the rent receivable as revenue and to disclose the fair value rent and the imputed subsidy in the notes to the general-purpose financial statements. This approach has the advantage that it is externally verifiable and follows the approach adopted in IPSAS 13. The disadvantage of this approach is that the amount of the subsidy given is not recognized in the statement of financial performance and does not follow the fair value approach proposed in this standard in respect of non-exchange transactions.

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- 6.21. The second approach, and that preferred by the Steering Committee, is to recognize the fair value rent as revenue and the difference between the fair value rent and the rent receivable as a transfer expense in the statement of financial performance. The advantages of this approach are that it is consistent with the fair value approach being proposed in respect of other non-exchange transactions and it recognizes the subsidies given in the statement of financial performance. The disadvantage of this approach is that it requires entities to ascertain the fair value of rent for the property being leased, and it recognizes a greater amount of revenue than rent receivable.

*Lessees*

- 6.22. Less frequently, public sector entities may be lessees of property for which the lessor charges less than fair value rent. For example a state government may rent a building to a national government for less than the fair value rent for that building. Normally, a lease is not perceived as generating any revenue for a lessee, rather it is an expense item. However, where the lease is a non-exchange transaction and the rent being charged is less than the fair value rent for that property, then the lessee effectively receives a transfer for the difference between the fair value of the rent and the rent payable. As for lessees there are two approaches to accounting for these leases:

- (a) recognize the rent payable as an expense in the statement of financial performance and disclose the imputed transfer in the notes to the general-purpose financial statements; and
  - (b) recognize the fair value rent as an expense, and the difference between the fair value rent and the rent payable as a transfer revenue in the statement of financial performance and make disclosures about the transaction in the notes to the general-purpose financial statements.
- 6.23. The Steering Committee is of the view that the accounting treatment of lessors and lessees should be complementary and therefore that option (b) above is the preferred option for both lessors and lessees. Adopting the fair value as the recognition basis for non-exchange transactions is the consistent view proposed by this ITC.

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## **Voluntary Services**

- 6.24. Many public sector entities are recipients of voluntary services. For example, a rural municipality may operate a volunteer fire brigade, a public hospital may receive the services of a surgeon visiting from another country, or a public school may receive the services of voluntary teachers' assistants. Public sector entities can also receive unpaid services from offenders as part of a punishment imposed by a court.
- 6.25. The Steering Committee considered three approaches to the recognition of voluntary services in the general-purpose financial statements of public sector entities. The first approach is to measure the fair value of all voluntary services provided to the reporting entity and to recognize that amount as both revenue and an expense in the general-purpose financial statements. The reporting entity would also make disclosures about the nature of the voluntary services and the method used to determine the fair value of those services. This approach has the advantage that it enables entities to recognize the full cost of providing its services during the reporting period and does not permit entities to subjectively exclude any services. Disadvantages of this approach are that many services provided to a reporting entity are not the type of services that the entity would acquire if they were not provided voluntarily, so recognizing revenues and expenses in relation to them could be perceived as misleading. Further, determining fair value for some services could be difficult and in some circumstances arbitrary, for example where a volunteer from a high cost country provides services in a low cost country, an entity could use the fair value to engage the volunteer costs in their home country, or the fair value of engaging a similarly qualified person in the country in which the service was provided.
- 6.26. The second approach is to recognize as revenue and an expense the fair value of those voluntary services that the entity would have to pay for if it did not receive them for free. The entity would also be required to disclose how it made the distinction between those services it would otherwise pay for and those it would not, and how the fair value of the services recognized was measured. This approach has the advantage that it requires the entity to recognize the full cost of providing those services considered to be essential to the continuing operation of the

entity. This approach has the disadvantage that entities are required to make a subjective decision as to whether services would be acquired if not provided free. Further the entity's productive capacity is increased by all the voluntary services it acquires, not just those it would otherwise pay for, which may mean that the general-purpose financial statements provide incomplete information about the financial performance of the reporting entity.

- 6.27. The third approach is not to recognize voluntary services in the general-purpose financial statements, but rather to disclose in the notes to the general-purpose financial statement the extent to which voluntary services contributed to the financial performance, position and cash flows of the reporting entity. This has the advantage that entities are not required to measure the fair value of all the services provided, nor to determine which services it would otherwise acquire. This approach has the disadvantage that the financial contribution made to the reporting entity by the utilization of voluntary services is not recognized in the financial statements.
- 6.28. The majority view of the Steering Committee is that voluntary services should not be recognized in the financial statements of public sector entity, but that disclosures about the general nature of the services provided should be made.

### **Pledges**

- 6.29. Pledges are promises to transfer assets to the entity. Pledges that meet the definition of an asset, and satisfy the criteria for recognition as an asset, should be recognized as assets and revenue. If a pledge has stipulations attached, entities need to consider whether these require the recognition of liabilities as indicated in Chapter 3. Pledges will meet the definition and satisfy the criteria for recognition when it is probable that economic benefits or service potential associated with the pledge will flow to the entity and can be reliably measured. In many cases, the entity will have insufficient control over the pledged resources until a transfer has actually taken place. However, in some instances the donor making the pledge can be relied upon to fulfill the pledge made, in which case the pledge may meet the definition of an asset and satisfy the criteria for recognition as an asset.

## **Gifts, Donations and Bequests**

- 6.30. Gifts and donations are transfers that one entity makes to another, normally free from stipulations and unlikely to recur on a regular basis. The donor may be any entity including a natural person. A bequest is a transfer made according to the provisions of a deceased person's will. The past event for gifts and donations is the receipt of the gift or donation, the past event for a bequest is the death of the testator, or the granting of probate, depending on the laws of the jurisdiction. As transfers, gifts, donations and bequests are recognized according to the proposals in Chapter 5.

## **Fines**

- 6.31. Fines are penalties imposed upon a person or entity by a court of law or a quasi-judicial body for violations of laws or administrative rules. Where a defendant reaches an agreement with a prosecutor that includes the payment of a penalty instead of being tried in court, that penalty payment would be considered to be a fine. In some jurisdictions law enforcement officials are able to impose fines on individuals considered to have breached the law, the individual will normally have the choice of paying the fine, or going to court to defend the matter. Fines normally require an entity to transfer a fixed amount of cash to the government.
- 6.32. The Steering Committee is of the view that when the receivable established by the fine meets the definition of an asset and satisfies the criteria for recognition as an asset, the receivable should be recognized as an asset and revenue should be recognized for the same amount. The fine receivable will not always be recognized as an asset immediately because at the time the fine is imposed, it may not be probable that the defendant will pay the fine, or pay the entire amount, either due to the insolvency of the defendant, or because the defendant appeals the case to a higher authority.
- 6.33. Where a fine is paid immediately in monetary assets, such as cash, the fine is measured at the nominal amount of those monetary assets. Where payment is delayed or is paid in installments, the reporting entity should consider whether the time-value of money is material, and if it is, the public sector

entity may need to consider using discounting to determine the fair value of the fine payments.

- 6.34. Where a fine is paid in non-monetary assets, the entity will measure the revenue at the fair value of the resources flowing to the entity. In many jurisdictions if an offender defaults on payment of the fine, court officials may seize assets to the value of the fine. In some jurisdictions, courts may include in a penalty the forfeiture of assets acquired with the proceeds of crime, for example, if a taxpayer were convicted of tax evasion, the court may seize assets of the taxpayer that were acquired with funds that should have been paid as taxes. Assets seized in these circumstances would be recognized initially at their fair value in accordance with IPSASs 16 and 17, and revenue recognized for the same amount.

### **Development Assistance**

- 6.35. Public sector entities may receive assets from international agencies, other governments, or non-government agencies within their own jurisdiction. If this development assistance takes the form of a loan, as is typically the case when a public sector entity receives development assistance from a multi-lateral development bank revenue is recognized in accordance with paragraphs 6.9 to 6.17 above.
- 6.36. Providers of development assistance often do not provide cash directly to a public sector entity. Most frequently development assistance is provided as non-monetary assets, such as a road, hospital or school. Where these assets are received as a transfer, revenue is recognized according to the proposals laid out in Chapter 5 of this ITC.

### **Preliminary Views**

9. *Where goods or services are purchased at less than fair value prices, the goods or services shall be recognized at their fair value, and the difference between the price paid and the fair value shall be recognized as revenue in the statement of financial performance.*
10. *Where goods or services are sold at less than fair value prices, entities shall recognize revenue equal to the fair value of the*

*goods or services sold, and the difference between the consideration received and the revenue recognized shall be recognized as an expense in the statement of financial performance.*

- 11. Where loans are extended by means of a non-exchange transactions, borrowers and lenders shall, on initial recognition, measure the loan principal at fair value, determined by reference to the borrower's incremental borrowing rate of interest. The difference between the fair value of the loan and the amount stated in the loan agreement shall be recognized as a transfer in the statement of financial performance in the period in which the loan is recognized.*
- 12. Where a creditor cancels liabilities, or another entity assumes liabilities, the debtor reporting entity shall recognize the decrease in the carrying amount of liabilities as transfer revenue in the period in which the decrease is recognized.*
- 13. Lessors of operating leases shall recognize as revenue the fair value rent of the leased property, the difference between the rent receivable and the fair value rent shall be recognized as a transfer in the statement of financial performance.*
- 14. Lessees of operating leases shall recognize as an expense the fair value rent of the leased property, the difference between the rent payable and the fair value rent shall be recognized as a transfer in the statement of financial performance.*
- 15. Voluntary services should not be recognized as revenue in the statement of financial performance, disclosures about the general nature of voluntary services received should be made.*
- 16. Pledges shall be recognized as assets when they meet the definition of an asset and satisfy the criteria for recognition as an asset. Revenue shall be recognized when an increase in net assets associated with the pledge is recognized.*

## Chapter 7 Implications for IPSAS 9

- 7.1. International Public Sector Accounting Standard IPSAS 9 Revenue from Non-Exchange Transactions was issued by the PSC in July 2001. It was based on International Accounting Standard IAS 18 (Revised 1993) "Revenue" issued by the International Accounting Standards Committee. Commentary in IPSAS 9 clarifies that it does not apply to "non-exchange transactions" which are also described in commentary. This commentary was used by the Steering Committee to develop the definitions of "exchange transactions" and "non-exchange transactions".
- 7.2. IPSAS 9 and IAS 18 deal principally with the recognition and measurement of revenue accruing to a reporting entity from the rendering of services, the sale of goods and the use by others of an entity's assets yielding interest, royalties or dividends. However IPSAS 9 only deals with these revenues if they accrue as a result of an exchange transaction. The focus of recognition of IPSAS 9 is when services are rendered, or when control of goods is passed to the purchaser, in a sense it is a outward flow, when the outflow is recognized, the inflow can be recognized.
- 7.3. As was stated in Chapter 1, the IASB is currently reviewing IAS 18 with a view to issuing an IFRS that conforms to the principles established in the IASB's *Framework for the Preparation and Presentation of Financial Statements*. The IASB project, together with this ITC render the pronouncements in IPSAS 9 somewhat out of date. This has implications for IPSAS 9 in that Government Business Enterprises will be required to recognize revenue on the new IFRS basis, whilst their controlling public sector entities will still be using IPSAS 9. As a result of this ITC public sector entities may be recognizing revenue from non-exchange transactions according to principles that are in accordance with the conceptual principles established in the IASB *Framework*. It should be noted that while the PSC has not adopted that the *Framework* as its own, but it has been influential in the development of this ITC
- 7.4. The most marked difference between IPSAS 9 and this ITC is a move away from an outflow or earnings type approach to an

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approach that focuses on changes in the statement of financial position. In particular this ITC has focused more on recognizing revenue after an asset has been recognized and any associated liabilities have been satisfied. If applied to all classes of revenue, this would mean that when recognizing revenue from the rendering of services, for example, entities would focus on the recognition of a receivable from the purchaser, and on the satisfaction of outstanding liabilities to the purchaser in the form of rendering services to the purchaser.

- 7.5. Another marked difference between the approach adopted in this ITC and IPSAS 9 is the focus on measuring assets and liabilities at fair value on initial recognition regardless of whether the consideration paid in respect of those assets is “nominal” or economically significant. The move away from the historic cost basis recognizes that in the public sector in particular, entities cannot assume that the price they pay for assets in the course of a non-exchange transaction will be the fair value.
- 7.6. These implications mean that in the near future IPSAS 9 may not be in harmony with world’s best practice for the recognition and measurement of revenue. Consequently, the Steering Committee has come to the view that there should, ultimately be one IPSAS on the recognition and measurement of revenue. A plan of action that could be adopted is to monitor the outcome of the IASB revenue project, which is anticipated to be completed by the first quarter of 2005, review the responses to this ITC and to develop a comprehensive exposure draft on revenue recognition in the public sector that encompasses both exchange and non-exchange transactions. The Steering Committee is also of the view that an IPSAS on the recognition and measurement of revenue from non-exchange transactions is needed in the short term rather than the medium to long term, so it would not favor a considerable delay in order to develop one IPSAS.

#### ***Preliminary View***

- 17. There should be one IPSAS on the recognition and measurement of revenue by public sector entities in the medium term.***

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## **Appendix 1 – Examples of Revenue from Non-Exchange Transactions**

- A1.1. This Appendix illustrates how various classes of revenue would be recognized and measured under the proposals outlined in this ITC.

### **Taxes**

#### *Income Taxes*

- A1.2. Income taxes are taxes levied on an entity's income during the taxation reporting period. They are often levied on a sliding scale such that higher income earners pay proportionately more tax than low-income earners. Taxable income is usually calculated as the gross assessable income less allowable deductions and rebates. Assessable income may exclude some items, for example some jurisdictions exclude gambling winnings from assessable income, and consequently do not allow deductions for gambling losses. Allowable deductions often include expenses incurred in earning assessable income, subject to the constraints of the tax law. Rebates are concessions allowed to certain taxpayers to encourage or discourage particular behavior, or to compensate for prescribed circumstances, for example some jurisdictions provide a rebate to taxpayers who have a spouse who is financially dependent upon them.
- A1.3. The past event for income tax is accruing taxable income in the taxation reporting period. Ideally income tax revenue should be recognized in the reporting period in which the taxable income is accrued. This is reinforced by the fact that governments are usually careful to ensure that their right to collect tax coincides with the earning of income, so that, for example, if a taxpayer died during the year, his or her estate would be liable for income tax on income earned up to the date of death. Most jurisdictions allow taxpayers more time to file their tax returns than reporting entities are permitted to prepare and authorize their general-purpose financial statements. As a consequence only a fraction of taxpayers' returns will have been processed by the time the financial statements are issued. Entities will not, therefore, be able to measure income tax revenue directly and will be required

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to measure income tax revenue indirectly for their financial statements. Such indirect measurements may be based on models using data such as amounts withheld by employers from the remuneration of wage and salary earners, statistical data on average earnings, gross domestic product and other indicators of income growth, as well as past years' taxation revenue data.

- A1.4. Some argue that because income tax revenue for the reporting period cannot be measured directly, tax revenue should be recognized on the basis of tax assessments issued to taxpayers or on the basis of cash received. These bases of recognition are not in accordance with the principles established in this ITC. If, however, the models mentioned in paragraph A1.3 are not able to provide reliable measurements of income tax revenue for the current reporting period, entities may have to delay recognition of tax assets and revenue until such time as the assets satisfy the recognition criterion of reliable measurement. In some circumstances this may be when tax returns are processed, or when cash is received.

*Dividend Tax or Secondary Tax on Companies*

- A1.5. Many governments levy taxes on the dividends a company pays its shareholders. These taxes may be a fixed proportion of the dividend, and may be levied on all dividends or only on dividends paid to particular classes of shareholder; for example, domestic shareholders may be exempt whilst foreign shareholders are taxed. In most cases the tax is receivable by the government when the company declares its dividend, although the cash payment may be made at another time, for example at the same time the cash payment of dividends is made to shareholders. These taxes may be additional to, or instead of, income taxes levied on company revenue.
- A1.6. The taxable event is the declaration of the dividend and the tax receivable and revenue would be recognized at that point, even the cash may not be received at that time. These taxes do not present measurement and recognition problems for reporting entities when the amount of the company dividend, and therefore the tax, are known. It is also probable, in these circumstances, that the economic benefits will flow to the entity because companies are unable to pay dividends to their shareholders

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unless they also pay the tax. However, in many jurisdictions there are a large number of very small companies, and some very complex corporate structures, which may result in the taxing government having difficulty identifying all the entities that are required to pay taxes on dividends, with consequential difficulties in recognizing tax assets and the associated revenue.

*Goods and Services Taxes*

- A1.7. Governments often levy taxes on the sales of goods and services. These taxes are levied as a proportion of the sale price, although taxpayers are usually given credit for the tax levied on any inputs to the goods or services sold. The entities selling goods and services are, in effect, collecting taxes on behalf of the government. In most instances they are required to submit regular returns to the tax authority detailing their sales revenue and the purchase of any inputs that were subject to tax, the taxing authority determines how much tax the entity is due to pay to the government.
- A1.8. The taxable event is the sale of taxable goods or services and/or the purchase of inputs subject to tax, during a tax reporting period. The reporting entity would normally recognize the revenue as the taxable sales and purchases take place, or as soon as it could reliably measure the taxation revenue. Measurement problems can arise if taxpayers seek to avoid paying sales tax by selling goods on the “black market”. Delays in processing tax returns can extend beyond the date the general-purpose financial statements are authorized, which can also materially affect the amount of tax assets and revenue that are recognized.

*Value Added Taxes*

- A1.9. Value added taxes are similar to taxes on the sale of goods and services, except that the tax is levied as a proportion of the difference between the sale price and the cost of the inputs purchased. The entities subject to value added taxes submit periodic returns to the taxation authorities that assess the amount of tax receivable by the government.
- A1.10. The taxable event is adding value to a taxable good or service. The reporting entity would, ideally, recognize tax revenue as

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value is added. Delays in recognition of tax revenue can occur due to the inability to reliably measure tax assets due to delays in processing tax returns, or fraudulent actions by taxpayers.

*Customs Duties*

- A1.11. Customs duties are a form of tax that is imposed on the import or export of goods and/or services. Duty is often levied as a percentage of the value of the goods being shipped, but may be levied as a fixed amount per unit of measurement, such as X currency units per kilogram or liter. Duty may be levied at the same rate for all goods and services or at different rates for different classes of goods and services, for example some countries levy duty at a higher rate if there is a domestically produced substitute for imported goods.
- A1.12. For customs duty, the taxable event occurs when the importer or exporter becomes liable to pay the duty, for example when the goods are imported or exported, or when the declaration is made, depending on local circumstances. Reliable measurement of customs duties can present difficulties to governments for a variety of reasons. Where taxpayers seek to avoid paying the full amount of duty they may seek to understate the taxable value of goods, or avoid customs duty altogether by failing to lodge customs documentation, or by smuggling goods into the country.
- A1.13. Measurement difficulties also arise when goods arrive in one reporting period, but the customs documentation is not processed until after the authorization of the general-purpose financial statements. For example, a container of goods may be offloaded in a port, but remain unclaimed for a significant period of time. The reporting entity may not be able to ascertain the nature of the contents of the container until it is claimed, which may prevent it recognizing the duty receivable on those imports. For example, goods may be placed in state warehouses when the importer has not yet fully paid customs duty or when they have been identified as smuggled goods. In such circumstances, the contents of the containers may be known and a reliable estimate can be made of the customs duty, but there is uncertainty regarding the probability of the flow of customs duty to the government. In such circumstances, the duty receivable would not be recognized as an asset because it is not probable that the

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economic benefits or service potential will flow to the reporting entity, consequently the associated revenue would not be recognized either.

*Capital Gains Taxes*

- A1.14. Capital Gains Taxes are taxes levied on the difference between a taxable asset's sale price and its purchase price. The tax is normally levied as a percentage of the gain, or a portion of the gain may be included in a taxpayer's income tax for the period in which the sale takes place. Some jurisdictions permit taxpayers to adjust the purchase price for inflation, and to include all costs of acquisition in the purchase price.
- A1.15. There are two views as to what constitutes the taxable event. The first view is that the sale is the taxable event and that the tax assets and revenue should be recognized in the period in which the sale takes place, provided that the definition of an asset is met and the criteria for recognition as an asset are satisfied. This approach presents measurement problems similar to those encountered with income tax, that is, the delays in processing returns may mean that the tax assets and revenue have to be measured indirectly, or recognition must occur when tax returns are processed.
- A1.16. The alternate and preferred view of the Steering Committee, is that the taxable event is the increase in value of taxable assets in each reporting period. That is, each period in which an asset increases or decreases in value results in an accrual to the reporting entity of an amount in respect of Capital Gains Tax that will eventually payable. This approach presents significant measurement problems because the reporting entity will have difficulty estimating the amount of taxable assets and the amount of change in their taxable value in respect of each period. These difficulties may inevitably mean that tax assets and revenue are not recognized until taxpayers file tax returns and those returns are processed.

*Property Taxes, Wealth Taxes, Gift and Death Duties*

- A1.17. These different taxes have the same basic characteristic: they levy tax as a percentage of the value of assets at a particular

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point in time. Property taxes levy tax as a percentage of the value of land, buildings or both on a stated date. Wealth taxes levy tax as a percentage of the net assets of a taxpayer on a given date. Gift taxes levy tax as a percentage of the value of transferred assets at the date of transfer. Taxes on deceased estates, often called death duties or inheritance taxes, are levied as percentage of the value of a deceased person's net assets (often called the dutiable amount) at the date of death or soon after. The taxable event occurs when the taxpayer becomes liable to pay property or wealth tax, usually on the date specified, the date of the gift or the date of death, or when a deceased estate is wound up.

- A1.18. The recognition and measurement of all these taxes can be problematic if there is a dispute as to the value of the items being taxed, such disputes, if material, may need to be resolved before revenue is recognized. Taxes on property are difficult for taxpayers to avoid because the item being taxed is immovable, and the taxing government can normally readily identify the taxpayer. In the case of wealth and gift taxes, taxpayers may seek to conceal wealth or gifts in order to avoid tax. These difficulties may reduce the level of probability that the entity will receive any or all of the economic benefits or service potential that are legally due, such that the recognition criteria are not satisfied. In the case of taxes on deceased estates, the administration of the estate may take many years to resolve and at the time of death, it may be impossible to determine the fair value of the estate, and consequently the amount of any tax receivable. Failure to meet the recognition criteria of reliable measurement of the deceased estate may therefore result in the tax receivable from the deceased estate not being recognized at the time of death.

## **Transfers**

### *Appropriations*

- A1.19. As noted in Chapter 5, appropriations are the authority for a public sector entity to spend public money. Appropriations result in an eventual transfer to a reporting entity. The past event for the transfer is not the appropriation, but the inflow of resources authorized by the appropriation. Appropriations can be

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established in one reporting period, but authorize the transfer of assets in another. For example, if a reporting entity had its annual appropriation for 20X2 established in December 20X1, and received resources as a result in the reporting period 1 January – 31 December 20X2, it would recognize the inflow of resources in its 20X2 financial statements, not in its 20X1 financial statements.

- A1.20. In many jurisdictions, legislatures establish special appropriations for frequently recurring expenditures that are largely non-discretionary. For example, a legislature may pass legislation to establish a social welfare system, and as part of that legislation it establishes a permanent appropriation for the public sector entity administering the system to spend whatever amounts are necessary to pay benefits. In these circumstances, because the appropriation does not specify an amount or a reporting period, there can be no doubt that any revenue would be recognized when the resources flow to the entity, not when the appropriation is established.

## **Other Revenue**

### *Fines*

- A1.21. Fines result in the accrual of revenue from non-exchange transactions as was stated in paragraphs 6.31 to 6.34. It should be noted however, that the fine assets and revenue would normally accrue to the entity that establishes the fine as a penalty and not the entity that imposes the fine. For example, if a national government delegated the administration of national crimes to state or provincial courts, fines imposed by those courts for breaches of the national law would normally accrue to the national government and not to the state or provincial government, which controls the courts for financial reporting purposes.
- A1.22. The preceding paragraph assumes that the fines imposed by one level of government accrue to that level of government irrespective of which level of government administers the judicial process. However, this assumption only applies where local laws establish that assumption. It is possible that in some

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jurisdictions local laws dictate that the level of government that administers the judicial process accrues the resulting fines.

*Non-exchange Fees*

- A1.23. As stated in paragraph 2.5, some jurisdictions impose fees on certain compulsory services that are clearly not exchange transactions. For example, a national government may require all residents to register their place of residence with their local government at the town hall. A particular local government charges residents a registration fee of 500 currency units, the council incurs costs of 50 currency units to perform the registration, and similar (although clearly not identical) services provided by other entities are priced at 75 currency units. It is clear in these circumstances that the registration fee is more in the nature of a tax, and is recognized as a non-exchange transaction rather than as a fee for service under IPSAS 9.

## **Appendix 2 – Qualitative Characteristics of Financial Reporting**

Paragraph 37 of this IPSAS 1 *Presentation of Financial Statements* requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. This appendix summarizes the qualitative characteristics of financial reporting.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

### **Understandability**

Information is understandable when users might reasonably be expected to comprehend its meaning. For this purpose, users are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, and to be willing to study the information.

Information about complex matters should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.

### **Relevance**

Information is relevant to users if it can be used to assist in evaluating past, present or future events or in confirming, or correcting, past evaluations. In order to be relevant, information must also be timely.

### *Materiality*

The relevance of information is affected by its nature and materiality.

Information is material if its omission or misstatement could influence the decisions of users or assessments made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

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## **Reliability**

Reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent.

### *Faithful Representation*

For information to represent faithfully transactions and other events, it should be presented in accordance with the substance of the transactions and other events, and not merely their legal form.

### *Substance Over Form*

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with their legal form.

### *Neutrality*

Information is neutral if it is free from bias. Financial statements are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

### *Prudence*

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated and liabilities or expenses are not understated.

However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

### *Completeness*

The information in financial statements should be complete within the bounds of materiality and cost.

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## **Comparability**

Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

Comparability applies to the:

- comparison of financial statements of different entities; and
- comparison of the financial statements of the same entity over periods of time.

An important implication of the characteristic of comparability is that users need to be informed of the policies employed in the preparation of financial statements, changes to those policies and the effects of those changes.

Because users wish to compare the performance of an entity over time, it is important that financial statements show corresponding information for preceding periods.

## **Constraints on Relevant and Reliable Information**

### *Timeliness*

If there is an undue delay in the reporting of information it may lose its relevance. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the decision-making needs of users.

### *Balance between Benefit and Cost*

The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a matter of judgment. Furthermore, the costs do not always fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information was prepared. For these reasons, it is difficult to apply a benefit-cost test in any particular case. Nevertheless, standard-setters, as well as those responsible for the preparation of Item 9.6 Invitation to Comment *Revenue from Non-Exchange Transactions (including Taxes, Transfers and Grants) Appendices*

financial statements and users of financial statements, should be aware of this constraint.

*Balance between Qualitative Characteristics*

In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.