



**INTERNATIONAL FEDERATION
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DATE: 29 SEPTEMBER 2003
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE
FROM: RICK NEVILLE
SUBJECT: **ITC REVENUE FROM NON-EXCHANGE TRANSACTIONS**

ACTION REQUIRED

The Committee is asked to:

- **review** the draft Invitation to Comment; and
- **approve** the draft Invitation to Comment (subject to any amendments agreed at the meeting) for publication.

AGENDA MATERIAL:

		Pages
9.2	Extract of minutes of PSC Meeting in July 2003	9.4 – 9.6
9.3	Draft ITC (clean version only)	9.7 – 9.90

There have been substantial changes to the ITC as a consequence of PSC decisions at the July meeting and the subsequent Steering Committee meeting in September. Consequently a clean copy is provided for your review at this meeting.

BACKGROUND

At its July 2003 meeting, the Public Sector Committee (PSC) reviewed a previous draft of the ITC in detail. The PSC's views on the draft ITC are recorded in the attached extract of minutes.

Following the PSC's July 2003 meeting the Steering Committee met in Paris from 3 – 5 September. That meeting considered the recommendations of the PSC and also made a number of changes to the content and structure of the ITC. This includes a change in the structure of the Flowchart, which also alters the structure of the other chapters.

Staff amended the ITC presented at the September Steering Committee meeting to take account of the views of the Steering Committee; however, time was very short so the Steering Committee members will be receiving the final ITC for comment, as it is circulated to the PSC. Therefore, any comments received from Steering Committee members will be included in the second distribution of agenda papers or tabled at the PSC meeting. Comments have been requested from Steering Committee members on a "fatal flaws" only basis.

We have revised the ITC in response to decisions of the Steering Committee in September and have responded to the concerns of the PSC as identified in Vancouver.

CHANGES TO ITC

Major changes to the ITC are outlined below. These changes have made the document considerably shorter than the version reviewed by the Steering Committee in Paris.

Preliminary

The Executive Summary has been rewritten to reflect the current content of the ITC. After the Executive Summary, a list of key definitions has been included. If the PSC agrees to the inclusion of the list of key definitions, one will be included in the Social Policy Obligations ITC as well. The Summary of Preliminary Views has been updated.

Chapter 1 Introduction

This chapter has been updated, in particular the section on the IASB update. The ITC does not define “transfer” but describes what is included.

Chapter 2 Principles

The flowchart has been revised so that the first question considered is the issue of contributions from owners. The chapter and subsequent chapters have been restructured to follow the revised flowchart. Material has been excluded that replicated material in other IPSASs. The chapter no longer deals extensively with reductions in liabilities as inflows of resources. The Steering Committee considered that debt forgiveness should be dealt with briefly and then put aside until the end of the ITC. Additional preliminary views have also been added to reflect more fully the assets and liabilities approach.

The Steering Committee has clarified its approach on dealing with transactions in which there is an exchange of unequal value. Where these transactions result in an increase in net assets/equity the ITC proposes that the increase in net/assets equity be recognized as revenue from non-exchange transactions and that the consideration given up and resources received in exchange be accounted for according to the terms of existing IPSASs.

Chapter 3 Taxes

This chapter was restructured to follow the new flow chart. The content remains largely unchanged. An additional preliminary view has been added, this preliminary view was expressed in “grey shading” previously.

Chapter 4 Transfers

This chapter incorporates the material on stipulations that was previously a separate chapter. The Steering Committee took the view that stipulations do not generally apply to taxes and so should focus on transfers. The material has been edited to make it more concise and focused. The chapter is considerably shorter than the two previous chapters. Additional preliminary views have been added to sharpen the focus of the chapter.

Chapter 5 Other Revenue

This chapter has been restructured to follow the revised flowchart and the changed view on composite transactions. The Steering Committee also revisited their view on voluntary services, and while it has not changed its preliminary view, it has changed the rationale for

adopting that view. The Steering Committee is not convinced that voluntary services meet the definition of an asset, and, therefore, do not fit into an assets and liabilities approach. The chapter is considerably shorter than the previous version because transactions in which unequal value is exchanged are treated under one heading rather than several.

Chapter 6 Implications for IPSAS 9

This chapter remains largely unchanged.

Appendix 1 Examples

This appendix has been completely revised. A number of examples were adapted from GASB 33 *Accounting and Financial Reporting for Nonexchange Transactions*, and where appropriate have been refocused to reflect the scope and reporting entities addressed by the ITC and the principles it proposes. Additional examples were added which reflect examples referred to in the body of the ITC.

The appendix that replicated the IPSAS 1 Appendix *Qualitative Characteristics of Financial Reporting* has been deleted. A reference is made in chapter 1 to that appendix.

ACTION REQUIRED

The PSC is requested to undertake a review of the comments from Steering Committee members as well as undertake a page-by-page review of the ITC and approve the ITC for issue.

Rick Neville

CHAIR, 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;
- a draft ITC *Revenue from Non-Exchange Transactions*; and
- comments from Steering Committee members.

Rick Neville introduced the topic and advised that the Steering Committee had not met between the April PSC meeting and this meeting, but that Staff had undertaken a major rewrite of the draft ITC, which had been circulated to the Steering Committee. Some comments have been received from Steering Committee members, but that time constraints meant that many members had had only a limited opportunity to review the draft. Rick outlined the major changes that have been included in the draft, including:

- relocating the definitions to the introductory chapter;
- amending the flowchart and accompanying commentary; and
- the drafting of Chapter 4 – 7 and the appendixes.

Rick noted that Staff have proposed that the flowchart be amended further so that Contributions from Owners are treated as exchange transactions, although still considered within the ITC. Rick advised that the Steering Committee had tentatively agreed to meet in Paris from 3 – 5 September.

Paul Sutcliffe, PSC Technical Director, noted that there would still need to be further refinements to the ITC so that both this ITC and the Social Policy Obligations ITC follow similar formats.

The PSC Chair led members through a page-by-page review of the ITC, members suggested that the Steering Committee:

- reexamine the title of the ITC in light of changes made to the chapter on transfers and grants;
- review the first specific matter for comment so that it reflects the intention of the Steering Committee. As currently drafted it may not reflect the view that an increase in an asset that is fully reflected in an increase in a liability does not result in the accrual of revenue;
- review with a view to clarifying the third specific matter for comment on contributions from owners, the current drafting does not clearly state the view that contributions from owners do take place in the public sector;
- revise paragraph 1.3 to note that the PSC also recognizes the benefits of comparability of financial reporting between the public and private sectors;
- revise the definition in paragraph 1.14, deleting “public sector” before “entity” as this is not the terminology the PSC uses;
- include in chapter 1, possibly at paragraph 1.15, a statement about the priority of substance over form. The notion is introduced in Chapter 5, but the concept is fundamental to the approach adopted by the Steering Committee;

- include in chapter 1 a definition of “transfer” if it is intended that the term have the specific technical meaning that chapter 5 suggests;
- revise the section on the IASB work and consider presenting a summary rather than the text of an IASB update and mention that the IASB should review the ITC in developing its own work;
- review paragraph 2.2, the current drafting is odd because it suggests that some argue against the ITC that hasn’t been released as yet;
- revise the examples in paragraphs 2.5, 2.9, 2.16 and 2.19. The current examples are not consistent with material elsewhere in the ITC. All examples should be non-exchange transactions;
- include a statement in paragraph 2.16, or chapter 4, about whether or not the right to tax is an asset;
- provide in paragraph 2.22 fundamental arguments as to why IPSASs 12, 16 and 17 need to be changed, consider enhancing the specific matter for comment;
- review the material on contributions from owners in light of the Eurostat document on the fundamental characteristics of contributions from owners. Steering Committee may want to consider being less direct in its view that “contributions from owners” not responsive (para 2.28) may wish to say “have reservations”;
- include a more explicit statement in paragraph 2.37 or 2.39 that revaluation is a remeasurement not revenue;
- give consideration to including disclosure requirements in chapter 2, for example requiring: separate disclosure of revenue from exchange and non-exchange transactions, disclosure information about measurement policies, and a reference to the disclosures required by IPSAS 1;
- review the location of paragraph 3.4 to give it more prominence to the definition of “stipulations”, which may make this rather difficult chapter easier to read;
- review the location of paragraph 3.7;
- revise the use of the term “funds”, if the term is intended to mean “monetary assets” that term should be used, otherwise the new term should be defined. The PSC is not convinced that monetary and non-monetary assets should be treated differently;
- review the arguments in paragraphs 3.30 to 3.36 in relation to timing requirements, the PSC is considers that the case in favor of timing requirements is not convincing and that if it is to be seriously proposed the arguments need strengthening;
- review the material on the “tax gap” in paragraph 4.8, PSC divided as to whether it should be included or not, consider an additional matter for comment on the “tax gap”, if included “bad debts” are not really part of tax gap;
- review paragraph 4.20 and consider reiterating more strongly that in some circumstances recognition of revenue under the accrual basis is when cash is received;
- revise preliminary view 5, “offsetting expenses against tax revenues should not be permitted”;
- revise paragraph 5.1, “transfer” may need to be defined as many would consider that “transfer” can include a transaction where there is some consideration;
- revise paragraph 5.4 to 5.7 so that the material on appropriations is expressed less definitively, as appropriations vary so much;

- revise paragraph 5.16 to give more guidance on what constitutes the past event for a payment made from a central bank account;
- consider whether paragraph 5.20 is needed, or whether it should be relocated with the other material on contributions from owners;
- review paragraph 6.8 it currently suggests two arguments – that the gross inflows result in an increase in net assets, and that they do not if the asset sold is carried at higher than the sale price – the Steering Committee should ensure that all views are presented to ensure consistency;
- review paragraph 6.18 – a literal reading of IPSAS 17 would see that IPSAS applied irrespective of whether the transaction is an exchange or non-exchange transaction, consider softening the wording of 6.18;
- revisit the section on voluntary services and explain why the Steering Committee thinks that its approach should be adopted when it is inconsistent with the approach generally adopted in the ITC;
- revisit the guidance in paragraphs A1.15 and A1.16, whilst paragraph A1.16 is consistent with the approach in IAS 12 *Income Taxes* it may not be the approach that is appropriate on the revenue side, which may be more in line with paragraph A1.15; and
- reconsider the inclusion of Appendix 2.

<i>Action Required:</i>	<i>Proceed with the preparation of a draft ITC for the September 2003 Steering Committee and November 2003 PSC meetings. Arrange Steering Committee meetings and prepare Steering Committee papers.</i>
<i>Person(s) Responsible:</i>	<i>SC Chair, Standards Staff.</i>

DRAFT AS OF 29 September 2003

Issued December 2003

Invitation to Comment

IFAC
Public
Sector
Committee

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

Issued for
comment by
the International
Federation of
Accountants



Draft ITC for PSC & SC Review as at 29 September 2003

The mission of the International Federation of Accountants (IFAC) is the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide services of consistently high quality in the public interest.

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Some of the examples in the Appendix are drawn from GASB Statement 33 *Accounting and Financial Reporting for Nonexchange Transactions*, issued by the Governmental Accounting Standards Board (GASB) and are used with the permission of GASB. GASB Statements are copyright of the Financial Accounting Foundation (FAF) and should not be used without the permission of the FAF.

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Introduction

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 revenue from non-exchange transactions, prior to the preparation of an Exposure Draft of an International Public Sector Accounting Standard.

Commenting on this Invitation to Comment

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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Preface

Steering Committee on Non-Exchange Revenue

Richard Neville, Vice-President and Chief Financial Officer, Royal Canadian Mint, (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.

Neil Jackson, Assistant Auditor-General, Queensland Audit Office, Australia.

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

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.

Specific Matters for Comment

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 net assets/equity 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 you believe there are circumstances in which “contributions from owners”, as defined, may be non-exchange transactions?
4. The Steering Committee proposes that some components of non-exchange transactions be accounted for in the same manner as exchange transactions. Do you agree with this treatment?
5. Do you think that an IPSAS on revenue should require separate disclosure of revenue from exchange transactions and revenue from non-exchange transactions?
6. Do you agree that “expenses paid through the tax system” should be recognized separately in the statement of financial performance?
7. Do you agree with the proposal that disclosures about the “tax gap” should be made in the notes to the general-purpose financial report?
8. Do you agree that, where physical assets are transferred to a reporting entity subject to conditions that they be consumed in the provision of goods and services, revenue should be recognized in respect of the transfer as the physical asset is consumed?
9. Do you agree with the Steering Committee’s conclusions regarding stipulations? That is, do you agree that:
 - (a) restrictions do not require entities to recognize liabilities;

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- (b) conditions require entities to recognize liabilities; and
 - (c) time restrictions require entities to recognize liabilities.
10. Do you agree that the PSC should develop one IPSAS on revenue that includes both exchange and non-exchange transactions within its scope?

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Appendix 1 – Examples of Revenue from Non-Exchange Transactions

Executive Summary

This Invitation to Comment (ITC) presents proposals for the recognition and measurement of revenue from non-exchange transactions in the general-purpose financial statements of public sector entities. Sometimes a non-exchange transaction may include a component that has the characteristics of an exchange transaction, this component should be recognized according to the provisions of existing IPSASs, irrespective of whether it is in a form normally identified with non-exchange transactions.

The ITC proposes adoption of an assets and liabilities approach to the recognition and measurement of revenue. It proposes that revenue from non-exchange transactions be recognized when a reporting entity recognizes an increase in net assets/equity, other than those relating to “contributions from owners”. An increase in net assets/equity will occur when an entity recognizes an asset and does not at the same time recognize a liability for the same amount. To be recognized as an asset, an inflow must meet the definition of an asset and satisfy the criteria for recognition as an asset.

The ITC proposes that when an entity recognizes an inflow of resources as an asset, that asset should be measured at its fair value and the entity would recognize revenue from non-exchange transactions for the amount of the increase in net assets/equity. When an inflow is recognized as an asset, the reporting entity must determine whether or not it has outstanding obligations in relation to the inflow that meet the definition of a liability and the criteria for recognition as a liability, such obligations are imposed by stipulations, which are discussed in detail in the chapter on transfers.

The ITC outlines application of its principles to taxes and to other non-exchange transactions. It identifies the past event that gives rise to the entity controlling a resource that meets the definition of an asset and satisfies the criteria for recognition as an asset. For taxes this past event is referred to as the taxable event and it is that event that a government has determined is subject to taxation. Preliminary View 5 identifies the taxable event for major taxes. The taxable event is the first point at which an entity can recognize an asset and revenue. The ITC notes, however, that at the time the taxable event occurs, the entity may not be able to reliably measure the asset, in which case the recognition of the asset and revenue will be delayed. The ITC notes that there are few circumstances in which a tax transaction will result in a liability that the taxing entity

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must recognize. The ITC discusses the tax gap (the difference between the taxes that are legally due, and those which the entity will be able to collect) and proposes that entities make disclosures about the tax gap in the notes to the general-purpose financial statements.

Public sector entities also derive significant revenue from transfers, which include grants, and appropriations, as well as gifts, donation and fines. The ITC applies the assets and liabilities approach to these types of non-exchange transaction. The most significant issue that arises in respect of these transactions is whether the recipient entity should recognize a liability in respect of the stipulations: imposed by the contributor entity on transfers of resources. The ITC identifies three types of stipulations: restrictions (which restrict the use of the asset, but do not require its return in the event of breach), conditions (which restrict the use of the asset and require its return in the event of a breach) and time requirements (which prohibit the use of the asset until a specified point in time). The ITC proposes that recipient entities recognize liabilities in respect of conditions and time requirements. As conditions are satisfied an entity reduces the liability and recognizes revenue. Time requirements are satisfied with the passage of time and when the prohibition on the use of the asset expires, the liability is reduced and revenue recognized.

The Steering Committee is of the view that this assets and liabilities approach can be applied equally to exchange and non-exchange transactions and proposes that the PSC develop one IPSAS on revenue that includes within its scope all revenue.

Key Definitions

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.

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.

A **non-exchange transaction** is a transaction that is not an exchange transaction. In a non-exchange transaction, an 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.

Stipulations are terms imposed upon the use of transferred assets by parties external to the entity.

Restrictions are stipulations that limit or direct the purposes for which transferred assets may be used, but do not specify that the assets must be returned to the contributor if not deployed as specified.

Conditions are stipulations that specify that transferred assets must be returned to the contributor if not deployed as specified, or if a specified future event occurs or does not occur.

Time requirements are stipulations that prohibit the use of transferred assets until a specified point in time.

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.

Summary of Preliminary Views*Chapter 2 – Principles*

1. *An inflow of resources from a non-exchange transaction should be recognized as an asset when it meets the definition of an asset and satisfies the criteria for recognition as an asset. (After paragraph 2.25)*
2. *Outstanding obligations related to the inflow of resources recognized as assets should be recognized as liabilities when they meet the definition of a liability and satisfy the criteria for recognition as liabilities. (After paragraph 2.30)*
3. *As an entity satisfies the obligations relating to the inflow of resources recognized as assets, it reduces the carrying amount of any liability recognized, and recognizes revenue. (After paragraph 2.30)*
4. *If there are no outstanding obligations in relation to an inflow of resources recognized as assets, an entity should recognize revenue immediately. The revenue from a non-exchange transaction should be measured at the amount of the inflow recognized as assets less any consideration given up. Where a non-exchange transaction includes an exchange component, that component should be recognized according to the provisions of the relevant IPSAS. (After paragraph 2.32)*

Chapter 3 – Taxes

5. *The taxable event for:*
 - (a) *income taxes is the earning of assessable income during the taxation period by the taxpayer;*
 - (b) *value added taxes is the undertaking of taxable activity during the taxation period by the taxpayer;*
 - (c) *goods and services taxes is the purchase or sale of taxable goods and services during the taxation period;*
 - (d) *customs duties is the movement of dutiable goods or services across the customs boundary;*
 - (e) *death duties is the death of a person owning taxable property; and*

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- (f) *property taxes is the passing of the date on which taxes are levied, or the period for which the tax is levied if the tax is levied on a periodic basis. (After paragraph 3.8)*
- 6. *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. (After paragraph 3.21)*
- 7. *In relation to taxes, offsetting of revenue and related expenses should not be permitted. (After paragraph 3.27)*
- 8. *Tax expenditures are foregone revenue, they are not expenses incurred by the entity. (After paragraph 3.27)*
- 9. *Expenses paid through the tax system are expenses incurred by the entity and should be recognized as expenses in the statement of financial performance. Tax revenue should be adjusted for the amount of any expenses paid through the tax system. (After paragraph 3.27)*

Chapter 4 – Transfers

- 10. *Determining when an inflow of resources that is subject to stipulations, results in the control of an asset will be a matter of judgment based on the nature of the stipulations and the circumstances facing the entity. (After paragraph 4.16)*
- 11. *Transfers of resources that are subject to stipulations will meet the definition of an asset of the recipient entity when the entity can use or otherwise benefit from the assets in pursuit of its objectives and can exclude or regulate the access of others to those benefits. (After paragraph 4.16)*

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12. *Cash transfers that are subject to stipulations and which are deposited in a bank account controlled by the recipient are, in fact, controlled by the recipient. (After paragraph 4.18)*
13. *An entity that recognizes transferred assets that are subject to restrictions should recognize revenue in respect of those assets immediately. (After paragraph 4.35)*
14. *A recipient should recognize a liability in respect of inflows of resources recognized as assets that are transferred subject to conditions. The liability should be reduced and revenue recognized as the conditions are satisfied. (After paragraph 4.36)*
15. *Monetary assets transferred subject to conditions should be recognized by the recipient as assets and as revenue, except to the extent that a liability is recognized in respect of those conditions. (After paragraph 4.39)*
16. *Non-monetary assets transferred subject to should be recognized by the recipient as assets and revenue, except to the extent that a liability is recognized in respect of those conditions. (After paragraph 4.42)*
17. *A recipient should recognize a liability in respect of inflows of resources recognized as assets that are transferred prior to the time period in which use of those resources is authorized. The liability should be reduced and revenue recognized when the time requirements are satisfied. (After paragraph 4.48)*
18. *Transfers, including grants and those arising from appropriations, are non-exchange transactions and should be recognized as revenue, to the extent that a liability is not recognized, 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/equity;*
 - (b) *it is probable that the future economic benefits or service potential will flow to the entity; and*

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- (c) *the fair value of the economic benefits or service potential flowing to the entity can be measured reliably.*
(After paragraph 4.49)

- 19.** *In relation to transfers offsetting of revenue and related expenses should not be permitted.* (After paragraph 4.52)

Chapter 5 – Other Revenues

- 20.** *Where entities provide or acquire goods or services in a non-exchange transaction and there is an increase in net assets/equity, the inflowing assets should be recognized at their fair value. The consideration provided should be recognized according to the provisions of the relevant International Public Sector Accounting Standard. The entity should recognize the increase in net assets/equity as revenue from a non-exchange transaction.* (After paragraph 5.11)
- 21.** *Where a creditor cancels liabilities, or another entity assumes liabilities, the debtor entity should recognize the decrease in the carrying amount of liabilities as revenue in the period in which the decrease in liabilities is recognized.* (After paragraph 5.21)
- 22.** *Voluntary services should not be recognized as assets or revenue in the statement of financial performance, disclosures about the general nature of voluntary services received should be made.* (After paragraph 5.26)
- 23.** *Pledges should be recognized as assets when they meet the definition of an asset and satisfy the criteria for recognition as an asset. Revenue should be recognized when an increase in net assets/equity associated with the pledge is recognized.* (After paragraph 5.27)
- 24.** *Fines should be recognized as assets and revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset.* (After paragraph 5.38)

Chapter 6 – Implications for IPSAS 9

- 25.** *There should be one IPSAS on the recognition and measurement of revenue by public sector entities.* (After paragraph 6.7)

Chapter 1 Introduction

- 1.1. Governments raise the majority of their revenue by means of non-exchange transactions, principally taxation, but also by means of transfers. Accrual based financial reporting in the public sector is still evolving and there is no internationally agreed method of accounting for and reporting on revenue arising from non-exchange transactions. International Public Sector Accounting Standard IPSAS 9 *Revenue from Exchange Transactions* excludes from its scope revenue arising from non-exchange transactions. Governments do raise some revenue from exchange transactions, and the existing IPSASs establish requirements for the recognition and measurement of this revenue.
- 1.2. The publication of this ITC is intended to promote consideration and debate of this issue. The ITC includes a number of preliminary views on the appropriate financial reporting of revenue arising from non-exchange transactions and seeks comments on these views. These are the views of the Steering Committee. They are not necessarily the views of the PSC. This ITC, and the responses to it, will provide input to the development of an Exposure Draft of an International Public Sector Accounting Standard (IPSAS), and an IPSAS.
- 1.3. This ITC applies the definitions and principles in International Public Sector Accounting Standards (IPSASs), particularly IPSAS 9, to a range of non-exchange transactions in order to determine the point at which revenues from these transactions should be recognized in the statement of financial performance. The ITC proposes an “assets and liabilities approach” that requires entities to recognize revenue when an inflow of resources occurs, to the extent that a liability is not recognized.
- 1.4. In developing this ITC, the Steering Committee was also cognizant of the qualitative characteristics of general-purpose financial reporting laid out in the appendix to International Public Sector Accounting Standard IPSAS 1 *Presentation of Financial Statements*.
- 1.5. This ITC deals with the general principles for the recognition and measurement of revenue from non-exchange transactions. Therefore it will not address all the possible variations of

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revenue that exist in every jurisdiction. The Steering Committee advocates that an IPSAS is prepared on the same basis.

Definitions

- 1.6. The Steering Committee, considered the existing definitions of the elements of general-purpose financial statements in IPSASs, and applied those principles to non-exchange transactions. A full list of all the terms defined by the PSC is reprinted in the *Glossary of Defined Terms IPSASs 1 – 20* published separately.
- 1.7. IPSAS 1 *Presentation of Financial Statements*, 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 revenue from non-exchange transactions. This definition requires that for revenue to arise there must be an increase in net assets/equity (an increase in assets, a decrease in liabilities or a combination thereof), other than increases relating to contributions from owners. This requires entities to focus on the definition and recognition criteria of assets and liabilities and to consider the nature of “contributions from owners” in the public sector.

Distinguishing between Exchange and Non-Exchange Transactions

- 1.9. It should be noted that in some jurisdictions the terms “reciprocal” and “non-reciprocal” are used rather than “exchange” and “non-exchange”. The PSC has previously used the terms “exchange” and “non-exchange” and that approach is continued in this ITC. The Steering Committee considers that the different terms have the same meaning.
- 1.10. Commentary in IPSAS 9 describes an exchange transaction as one in which entities directly exchange approximately equal value. For the purposes of this ITC the following definition has been adopted:

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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.

- 1.11. For the purposes of this ITC a non-exchange transaction is a transaction other than an exchange transaction; the following definition has been adopted:

A non-exchange transaction is a transaction that is not an exchange transaction. In a non-exchange transaction, an 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.

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.

- 1.12. These definitions provide the basis for distinguishing between exchange and non-exchange transactions throughout this ITC. 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 and transfers (including transactions described as grants, appropriations, donations and such items as fines, debt forgiveness and voluntary services). When determining whether a transaction is an exchange transaction or a non-exchange transaction, entities would examine the substance of the transaction. A transaction may have the form of a non-exchange transaction, for example a grant, but the recipient is required to provide goods or services of approximately equal value directly to the transferor in return, so in substance the transaction is an exchange transaction.
- 1.13. Transactions in which the recipient entity provides no value to the transferor are included within the definition of non-exchange transaction.

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- 1.14. 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. The Steering Committee is of the view that its proposed approach could be applied to revenue from exchange and non-exchange transactions alike. This would 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 conceptual framework that is implicit in the existing IPSASs. 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 of revenue from non-exchange transactions 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.

Transfers

- 1.15. The term “transfer” is commonly used to describe various types of payment to public sector entities. In some jurisdictions the term will refer only to payments for which the recipient entity provides no value directly in return. In other jurisdictions, the term will encompass circumstances where the recipient entity provides some value directly in return.
- 1.16. The Government Finance Statistics Manual 2001 (GFSM 2001, paragraph 3.8) defines a transfer as “A transaction in which one unit provides a good, service, asset, or labor to a second unit without receiving simultaneously a good, service, asset or labor of any value in return.” This ITC adopts a broader notion of transfer, which encompasses transactions where there may be some exchange of value, but not equal value. The notion of transfer also encompasses transactions where the recipient entity provides resources to third parties at the direction of the contributor of those resources. Transfers do not, however, include taxes.
- 1.17. Chapter 4 of this ITC deals with transfers in detail.

Draft ITC for PSC & SC Review as at 29 September 2003*Stipulations¹*

- 1.18. Inflows of resources derived from a non-exchange transaction often have stipulations attached that restrict or impose conditions on their use. The Steering Committee proposes that in certain circumstances the stipulations may result in the inflow failing to meet the definition of an asset, or may give rise to a liability that the reporting entity should recognize. Where a liability is recognized, revenue should be recognized as that liability is discharged. If the inflow of assets occurs without stipulations attached that inflow would be recognized as revenue immediately provided it is not a contribution from owners. Entities also need to assess whether the stipulations are such that the transaction is, in substance, an exchange transaction.
- 1.19. For the purposes of this ITC, the Steering Committee has adopted the following definitions:

Stipulations are terms imposed upon the use of transferred assets by parties external to the entity.

Restrictions are stipulations that limit or direct the purposes for which transferred assets may be used, but do not specify that the assets must be returned to the contributor if not deployed as specified.

Conditions are stipulations that specify that transferred assets must be returned to the contributor if not deployed as specified, or if a specified future event occurs or does not occur.

Time requirements are stipulations that prohibit the use of transferred assets until a specified point in time.

- 1.20. Stipulations are most frequently imposed upon transfers, however, they can be imposed upon any non-exchange transaction. Stipulations are discussed more fully in Chapter 4 which deals with transfers.

¹ In its discussion of stipulations, the Steering Committee has drawn on the work of Westwood, Mark and April McKenzie *Accounting by Recipients for Non-Reciprocal Transfers, Excluding Contributions by Owners: Their Definition, Recognition and Measurement*, Financial Accounting Standards Board, Norwalk, USA, 1999.

Draft ITC for PSC & SC Review as at 29 September 2003*Control of an Asset*

- 1.21. IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* defines control in relation to controlled entities. The Cash Basis IPSAS *Financial Reporting Under the Cash Basis of Accounting* defines “control of cash”. On the basis of these principles the Steering Committee has developed the following definition of control of an asset:

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.

The definition “asset” refers to resources which represent future economic benefits or service potential. “Control of an asset” therefore applies to resources that represent future economic benefits or service potential. The definition is not intended to imply that entities can recognize as an asset expenditure that provides current but not future economic benefits to the entity unless another IPSAS explicitly permits such recognition.

Structure of the ITC

- 1.22. This section outlines matters considered in the remaining chapters of this ITC.
- 1.23. Chapter 2 proposes general principles for the recognition and measurement of revenue from non-exchange transactions.
- 1.24. Chapter 3 deals with the recognition and measurement of assets and revenues arising from taxes. Issues addressed include:
- (a) when to recognize assets and revenue arising from a government’s right to tax;
 - (b) tax expenditures and when to separately recognize obligations that are settled through the tax system; and
 - (c) determining the probability of the inflow of resources.
- 1.25. Chapter 4 deals with the recognition and measurement of assets and revenues arising from transfers (including those described as “grants” and “appropriations”). Issues addressed include:
- (a) determining whether appropriations give rise to revenue;
 - (b) measurement of donated non-monetary assets; and

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- (c) whether stipulations, including restrictions, conditions and timing requirements:
 - (i) affect whether an item satisfies the definition of an asset, or
 - (ii) require an entity to recognize a liability, and how such liabilities are discharged and revenue recognized.
- 1.26. Chapter 5 deals with the recognition and measurement of revenues arising from other non-exchange transactions. Issues addressed include:
 - (a) transactions which increase net assets/equity, have some of the characteristics of exchange transactions, but which are conducted at prices that do not approximate fair value;
 - (b) debt forgiveness;
 - (c) pledges; and
 - (d) voluntary services;
- 1.27. Chapter 6 discusses the implications of the approach proposed in the ITC for revenue recognized under IPSAS 9. The view of the Steering Committee is that the PSC should look to develop one IPSAS on the recognition and measurement of revenue from non-exchange transactions based on the approach developed in this ITC.
- 1.28. Appendix 1 provides examples of how particular transactions would be recognized and measured under the approach developed in this ITC.
 - (a)

IASB Projects

- 1.29. The IASB currently has several projects under way which overlap with the scope of this ITC. The paragraphs below outline the status of those projects at XX November 2003, the date of approval of this ITC.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.

- 1.30. The project that is likely to be completed first is a project to revise International Accounting Standards IAS 20 *Accounting for Government Grants and Disclosure of Government*

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Assistance for consistency with the *Framework for the Preparation and Presentation of Financial Statements*. As at XX November 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*. IAS 41 requires entities to recognize revenue from unconditional grants when the grant is receivable, and revenue from conditional grants when the conditions are met.

IAS 18 Revenue

- 1.31. The IASB is undertaking a joint project with the Financial Accounting Standards Board (FASB) in the USA to develop a comprehensive set of principles for revenue recognition that will eliminate the inconsistencies between IAS 18 *Revenue* and the *Framework for the Preparation and Presentation of Financial Statements*. The IASB expects to publish Exposure Drafts revising IAS 18 and the *Framework* in 2004. The IASB is exploring an approach that focuses on changes in assets and liabilities and is not overridden by tests based on notions of an earnings process.
- 1.32. The IASB has expressed a concern that that under the assets and liabilities approach, when the carrying amounts of assets sold equal or exceed the value of the assets obtained in return, it may be concluded that an increase in equity has not occurred and no revenue should be recognized. The IASB has decided that it needs to clarify whether the notion that an increase in equity is an essential characteristic of revenue. The Steering Committee has decided not to pre-empt the deliberations of the IASB and for the purposes of this ITC has decided to retain the current definition of revenue. The PSC may consider the possibility of revising the definition at the Exposure Draft stage if the IASB proposes doing so.
- 1.33. The IASB's anticipated approach is similar to that being proposed in this ITC. It is anticipated that this ITC will be published at about the same time as the IASB Exposure Draft and this ITC will be made available to the IASB for their consideration as they review the responses to their Exposure Drafts.

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- 1.34. The IASB's Exposure Draft on International Financial Reporting Standard will be considered when a PSC Exposure Draft is prepared.

Measurement

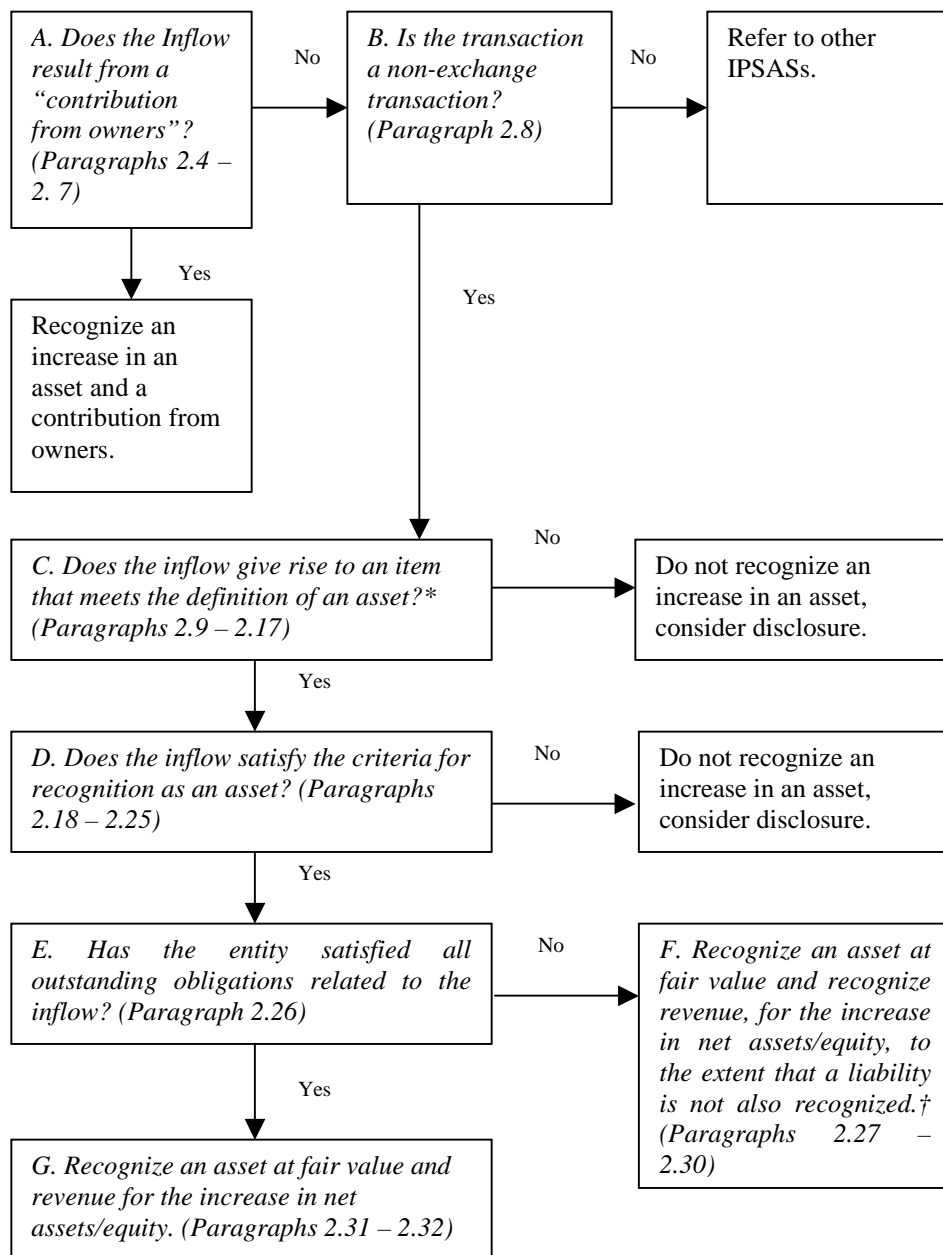
- 1.35. The IASB has begun research into resolving issues related to the selection of the appropriate measurement of items recognized in the financial statements. Any project undertaken would be likely to result in amendment or expansion of the discussion of measurement in the IASB's *Framework for the Preparation and Presentation of Financial Statements*. Consequences of this should be considered in the next stage of the PSC's project on revenue from non-exchange transactions.

Chapter 2 Principles

Recognition of Revenue from Non-Exchange Transactions

- 2.1. This ITC develops an “assets and liabilities approach” that requires entities to recognize revenue when an inflow of resources occurs, to the extent that a liability is not also recognized.
- 2.2. The flow chart on the following page illustrates the analysis to be undertaken when there is an inflow of resources to determine whether to recognize revenue:
- 2.3. Many public sector entities receive resources as contributions from their controlling entity, either the government or another public sector entity. Such transactions are usually exchange transactions because the parties to the transaction exchange approximately equal value. In these cases, the recipient recognizes an increase in an asset or decrease in a liability, and the contributor recognizes an increase in an asset (the investment in the entity) equal to the amount given up. It is also possible that entities will receive contributions from owners other than a controlling entity, such as is the case with joint ventures, and jointly owned entities not subject to the control of another entity. Examples of circumstances in which an entity might receive a contribution from owners include:
 - (a) an initial investment to establish the entity;
 - (b) an additional investment to expand the operating capacity of the entity; and
 - (c) merging of another entity’s operations into those of the reporting entity.

Initial Recognition of Inflows of Resources from Non-Exchange Transactions



Draft ITC for PSC & SC Review as at 27 September 2003**Footnotes to Flowchart:**

- * In certain circumstances, such as when a creditor forgives a liability, an inflow may decrease the carrying amount of a previously recognized liability. In these cases instead of recognizing an asset at fair value the entity decreases the carrying amount of a previously recognized liability and revenue for the amount of the increase in net assets/equity (paragraph 2.17).
- † It is possible that value is transferred from the transferee to the transferor in a non-exchange transaction and therefore that a non-exchange transaction could give rise to both a liability and revenue (paragraph 2.27 – 2.30).

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

A. Does the inflow result from a “contribution from owners”?

2.4. IPSAS 1 defines contributions from owners as follows:

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.

2.5. In the private sector, an entity that wholly owns another entity (an owner entity) effectively has the option, when providing resources to the owned entity, of determining whether that contribution of resources will be in the form of a “contribution from owners”, a loan or revenue. The issue of shares or other equity instruments 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

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liability. In the absence of evidence of a “contribution from owners” or a loan from owners, revenue should be recognized.

- 2.6. The Steering Committee is of the view that the same process is available in the public sector. Owner entities in the public sector may contribute resources to a controlled entity, such as a government department. The public sector management model in place and the circumstances and purpose of the contribution will influence the form of the contribution. The contribution may be in the form 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 contribution from the owner entity that is to be recognized as a liability. However, a public sector entity is unlikely to be a company with share capital that would enable it to issue new shares to its owning entity. Therefore, 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 contributor or a controlling entity of the contributor as forming part of the recipient’s net assets/equity, either before the contribution occurs or at the time of the contribution;
 - (b) a formal agreement, in relation to the contribution, establishing a financial interest in the net assets/equity of the recipient which can be sold, transferred or redeemed; or
 - (c) the issuance, in relation to the contribution, of equity instruments which can be sold, transferred or redeemed.¹
- 2.7. Some argue that the concept of “ownership”, whilst appropriate in the private sector, is not directly applicable to the public sector and that different terminology such as “contributions from controlled entities” or “direct contribution to net assets/equity” is more appropriate. Others argue that the concept of a contribution to the net assets/equity of a public sector entity is inappropriate

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

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and should not be endorsed by the PSC. However, the Steering committee is, of the view that such contributions arise in the public sector, including in respect of joint ventures where there is no controlling entity, and also where a whole-of-government or other reporting entity consolidates a controlled partly privatized entity.

B. Is the transaction a Non-Exchange Transaction?

- 2.8. Non-exchange transactions are defined in paragraph 1.12. Examples of non-exchange transactions include revenue from the use of sovereign powers (for example, direct and indirect taxes, duties, and fines) and transfers. In distinguishing between exchange and non-exchange transactions, the substance rather than the form of the transaction should be considered. For example, sale of goods is normally classified as an exchange transaction, however if the transaction is conducted at a subsidized price, that is a price that is not approximately equal to the value of the goods sold, that transaction falls within the definition of a non-exchange transaction. In determining whether the substance of a transaction is that of a non-exchange or an exchange transaction, entities will need to exercise judgment.

C. Does the inflow give rise to an item that meets the definition of an asset?

Definition of Assets

- 2.9. 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 2.10 to 2.16 explain key aspects of this definition.

Control

- 2.10. The definition of “control of an asset” in paragraph 1.19 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.

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- 2.11. 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. In the public sector, governments exercise a regulatory role over certain assets such as financial instruments or bank accounts, which may enable the government to regulate access to those assets. This regulatory role does not necessarily mean that such regulated assets 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 assets.

Stipulations

- 2.12. Stipulations are defined in paragraph 1.18 as "terms imposed upon the use of assets by parties external to the entity". Entities will need to exercise judgment to determine whether, in the particular circumstances, stipulations imposed on a contributed resource are such that the resource does not meet the definition of an asset. Stipulations are discussed more fully in Chapter 4.

Administered Assets

- 2.13. 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. Administered transactions may also occur when one government collects taxes on behalf of another. 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 recognize 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.
- 2.14. Public sector entities that administer items or programs on behalf of the government are usually required to prepare and publish financial statements in respect of these items or programs. The information contained in those administered/trust financial statements provides information to the users of public sector

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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. The IPSASs and the proposals in this ITC may usefully be applied to administered items where relevant.

Past Event

- 2.15. The assets of an entity arise from past transactions or other events, which result in the entity controlling resources (past event). 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 purchase, "taxable event", or a transfer. 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 is not a past event that meets the definition of an asset. An item that possesses 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

- 2.16. 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".

Decrease in a Liability

- 2.17. In certain circumstances, such as where a creditor forgives a debt that the entity has previously recognized as a liability, the inflow of resources will take the form a decrease in a liability. A decrease in a liability also results in an increase in net assets/equity. The amount of the increase in net assets/equity is equal to the reduction in the carrying amount of the liability. For example, if a national government had previously extended a

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loan to a local government, and subsequently forgives that debt, the local government reduces its liability and recognizes revenue. The definition of a liability and the criteria for recognizing a provision are discussed in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, these requirements are equally applicable to other liabilities.

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* require 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 the future economic benefits or service potential associated with the asset will flow to the entity; and
- (b) the fair value or cost of the asset to the entity can be measured reliably.¹

These criteria are equally applicable to all assets.

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. Alternatively, the entity may not be able, on reporting date, to reliably measure the asset.

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 based on 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

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

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from the future economic benefits or service potential in the pursuit of its objectives. For example, a taxpayer who is engaged in clandestine activities may be obliged to pay income taxes in respect of income earned from those activities, but if those activities are unknown to the tax authorities, it is not probable that future economic benefits will flow to the entity in respect of that taxable activity.

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.
- 2.22. The IPSASs do not prescribe recognition and measurement requirements for assets other than inventory, construction contract assets, 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. In the case of assets acquired by means of an exchange transaction, the cost of the asset will be its fair value. However, where assets are acquired by means of a non-exchange transaction, any consideration paid for the asset will not reflect the asset's fair value.
- 2.23. The development of the proposal to distinguish the treatment of assets acquired through exchange transactions from those acquired through non-exchange transactions has its origins in IPSAS 16 and 17, which require that where assets acquired at no cost or a nominal cost, cost is the fair value at the date of acquisition. The definition of non-exchange transaction proposed in this ITC recognizes that the notion of what constitutes a non-exchange transaction is more than "no cost or a nominal cost" but is a cost that is not approximately equal to the fair value of the asset. The Steering Committee is of the view that where an asset is acquired in a non-exchange transaction, its cost should be its fair value on the date of acquisition. Any difference between the fair value and any consideration paid should be recognized as a revenue or expense from a non-exchange transaction in the period in which the asset is acquired. Initially measuring all assets at fair value will require amendments to IPSASs 12, 16 and 17.

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- 2.24. Determining fair value in the public sector can be a difficult issue for some assets, for example heritage assets for which no market exists. This is recognized in IPSAS 17, which does not require entities to recognize heritage assets. Measurement of donations can also be a difficult issue in some cases. 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 identify the full extent of that estate. In all such circumstances the entity needs to consider whether the items meet the definition of “contingent asset” in IPSAS 19, and should be disclosed as contingent assets, that may or may not be recognized as assets in the future.

Items Not Meeting the Definition of An Asset or Satisfying the Criteria for Recognition as an Asset

- 2.25. In some circumstances an entity may receive a resource that does not meet the definition of an asset or the criteria for recognition as an asset. In these circumstances, the entity needs to consider whether the item is a contingent asset as defined in IPSAS 19, which must be disclosed. IPSAS 19 establishes the requirements for such disclosures.

Preliminary View

1. ***An inflow of resources from a non-exchange transaction should be recognized as an asset when it meets the definition of an asset and satisfies the criteria for recognition as an asset.***

E. Has the Entity Satisfied All Outstanding Obligations Related to the Inflow?

- 2.26. When, as a result of a non-exchange transaction, an entity recognizes an asset it must also determine if it has satisfied all outstanding obligations related to the inflow of resources.

F. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity to the extent that a liability is not also recognized

- 2.27. If the entity has not satisfied all outstanding obligations, it will need to determine whether the outstanding obligations meet the

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definition of a liability and satisfy the criteria for recognition as a liability. For example, a grant may specify the provision of services to third parties and this may give rise to a liability.

Definition of Liabilities

2.28. 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.

Criteria for recognition as a liability

2.29. IPSAS 19, paragraph 22 establishes recognition criteria for provisions. A provision is recognized as a liability 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. These criteria are equally applicable to liabilities other than provisions.

Stipulations

2.30. As noted in paragraph 1.18, resources derived from non-exchange transactions often have stipulations attached that impose conditions or time requirements on the use of resources recognized as assets. In such circumstances, the entity will need to exercise judgment to determine whether those conditions or time requirements require the entity to recognize a liability in respect of part or all of the inflow of assets. Stipulations are more commonly attached to transfers than to other types of non-exchange transactions and as such, they are discussed more fully in Chapter 4. Where stipulations have given rise to the recognition of a liability, revenue will be recognized as those stipulations are satisfied and the liability discharged. Chapter 4

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provides detailed guidance on the circumstances under which stipulations are initially recognized as liabilities and subsequently satisfied.

Preliminary Views

2. ***Outstanding obligations related to the inflow of resources recognized as assets should be recognized as liabilities when they meet the definition of a liability and satisfy the criteria for recognition as liabilities.***
3. ***As an entity satisfies the obligations relating to the inflow of resources recognized as assets, it reduces the carrying amount of any liability recognized, and recognizes revenue.***

G. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity

- 2.31. If the entity has satisfied all outstanding obligations it will recognize revenue for the increase in net assets/equity. In some non-exchange transactions one entity will provide some value, but not approximately equal value, in exchange for the assets or services it receives from the other entity. In such cases, one entity will receive an asset or service, but give up an existing asset, or provide some service to the other party. In these cases, the non-exchange transaction comprises two components:
 - (a) one component is an exchange transaction for the amount of the consideration exchanged and should be recognized according to the provisions of the relevant IPSAS, such as IPSAS 9 for sale of goods and services, IPSAS 16 for investment property or IPSAS 17 for property, plant and equipment; and
 - (b) the other component is a non-exchange transaction and revenue recognized from this component should be measured at the amount of the inflow less any consideration given up.
- 2.32. 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

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that should be recognized separately in the financial statements.
For example,

- (a) 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;
- (b) 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; or
- (c) 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 is a remeasurement and 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.

Preliminary Views

4. ***If there are no outstanding obligations in relation to an inflow of resources recognized as assets, an entity should recognize revenue immediately. The revenue from a non-exchange transaction should be measured at the amount of the inflow recognized as assets less any consideration given up. Where a non-exchange transaction includes an exchange component, that component should be recognized according to the provisions of the relevant IPSAS.***

Basis for Adopting this Approach

- 2.33. The Steering Committee has considered alternative approaches. However, it has rejected them but has rejected them because they are inconsistent with the conceptual framework that is implicit in the existing IPSASs, 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 or costs with revenues requires the use of a concept of

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earnings that will often not be applicable in the case of revenue from non-exchange transactions.

Chapter 3 Taxes

- 3.1. Taxes are the major source of revenue for many governments. The Government Finance Statistics Manual 2001 defines taxes as compulsory transfers to the government, this ITC adopts a similar notion of taxes.¹ 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. A government, whether supra-national, national, state/provincial or local exercises “sovereign powers” when it can legally enforce its decisions.
- 3.2. 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 generally 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.

Application of Flowchart to Taxes

A. Does the Inflow result from a “contribution from owners”?

- 3.3. Taxes do not give rise to a contribution from owners as defined in IPSAS 1 and as described in paragraphs 2.4 to 2.7.

B. Is the Transaction a non-exchange transaction?

- 3.4. Taxpayers are compelled by law to transfer resources embodying future economic benefits or service potential to the government without directly receiving approximately equal

¹ *Government Finance Statistics Manual 2001*, International Monetary Fund, 2001, paragraph 4.21.

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value (in the form of goods or services) from the government in return. As such taxes are non-exchange transactions.

C. Does the inflow give rise to an item that meets the definition of an asset?

- 3.5. Assets flowing to the entity must meet the definition of an asset. That is they must be controlled by the entity, as a result of past events, from which future economic benefits or service potential are expected to flow to the entity.

Past Event – Taxable Event

- 3.6. Taxes give rise to assets 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.

Control

- 3.7. 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.
- 3.8. The following preliminary views indicate when the taxable event occurs, and when control of an asset arises, for certain types of taxes, and hence the earliest point at which tax assets, and revenue which satisfy the recognition criteria can be recognized:

Preliminary View

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5. *The taxable event for:*

- (a) *income taxes is the earning of assessable income during the taxation period by the taxpayer;*
- (b) *value added taxes is the undertaking of taxable activity during the taxation period by the taxpayer;*
- (c) *goods and services taxes is the purchase or sale of taxable goods and services during the taxation period;*
- (d) *customs duties is the movement of dutiable goods or services across the customs boundary;*
- (e) *death duties is the death of a person owning taxable property; and*
- (f) *property taxes is the passing of the date on which taxes are levied, or the period for which the tax is levied if the tax is levied on a periodic basis.*

The Tax Gap

- 3.9. For many taxes, the reporting entity will be aware that the amount that the government is entitled to collect under the tax law is higher than the amount that will be collected. The amount collected is lower due to fraud, evasion, non-compliance with the tax law, and error. 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***. Amounts previously included in tax revenue that are determined as not collectible do not constitute part of the tax gap.
- 3.10. The Steering Committee has considered two approaches to accounting for the tax gap. The first approach would require entities to estimate the full amount of legally due under the tax law, and to recognize that amount as revenue. The entity would also be required to recognize an expense for the amount of the “tax gap”. This approach has the advantage that it clearly illustrates the amount of tax being avoided through fraud and error. However, it has the disadvantage that it recognizes an amount as revenue that it is not probable the entity will receive. The Steering Committee questioned whether these amounts would meet the definition of an asset, as there is no expectation that they would provide future economic benefits or service potential to the entity.

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- 3.11. The second approach, and that favored by the Steering Committee is to disclose in the notes to the general-purpose financial statement such information about the tax gap as can be reliably estimated. This approach has the advantage that information about the tax gap will be disclosed, but will not distort the statement of financial performance. This approach has the disadvantage that it does not give as much prominence to the loss the government sustains due to fraud and error.

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

- 3.12. For recognition as assets, inflows of resources must also satisfy the criteria for recognition, that is it must be probable that the inflow of resources embodying economic benefits or service potential will occur, and can be reliably measured.¹ 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 the inflow of resources before it can be recognized, which may not be possible until some time after the tax accrues to the government.
- 3.13. 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 amount of 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.

Probable Inflow of Future Economic Benefits

- 3.14. Assessing the probability that taxes will give rise to an inflow of future economic benefits or service potential is crucial to determining when to recognize assets and revenue resulting from a taxation transaction. Having identified that the entity is entitled to collect taxes, the entity must make a determination as

¹ See paragraphs 2.18 to 2.25 for a discussion on the criteria for recognition as an asset.

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to the probability of the inflow of resources. If it were 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

3.15. Reliably measuring the assets, and therefore the revenue, accruing to the government at the time the taxable event occurs can be difficult for many governments. The nature of taxation systems is such that whilst the amount of the majority of assets and revenue can be reliably measured, there is a material amount that is more difficult to measure. Difficulties arise due to:

- (a) the tax law allowing taxpayers a longer period to lodge returns than the government is permitted for publishing general-purpose financial statements;
- (b) taxpayers failing to lodge returns on a timely basis;
- (c) valuing non-monetary assets for tax assessment purposes;
- (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.

3.16. The difficulties associated with reliable measurement may mean that some assets and the related revenue cannot be recognized until some considerable time after the taxable event occurs, for example if a tax base is volatile and estimation is not possible. 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.

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E. Has the entity satisfied all outstanding obligations related to the inflow?

- 3.17. 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. Consequently, governments will not incur obligations to tax payers as a consequence taxpayers paying taxes. There are two exceptions to this general observation that are discussed in section F below.

F. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity, to the extent that a liability is not also recognized.

- 3.18. The first type of liability that can arise with respect to the inflow of resources resulting from tax transactions is, principally, the liability for refunds of overpaid taxes. This occurs 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.

- 3.19. In some jurisdictions, some taxes are set aside or "earmarked" by the legislature for specified expenditure. In determining whether such earmarked taxes require the entity to recognize a liability in respect of them, entities would refer to the sections in the next chapter on stipulations and to IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

G. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity.

- 3.20. Where there are no externally imposed stipulations on the use of tax assets, or liabilities related to overpaid taxes, the reporting entity will recognize revenue from non-exchange transactions for the increase in net assets/equity resulting from the taxation transaction.

Preliminary View

6. *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.*

Presentation of Tax Revenue

- 3.21. 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.
- 3.22. 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.

Tax Expenditures and Expenses Paid Through the Taxation System

- 3.23. The Steering Committee believes tax expenditures and expenses that are paid through the tax system are different in nature and therefore distinguishes between them for accounting purposes.
- 3.24. ***Tax expenditures*** are preferential provisions of the tax law that provide taxpayers with concessions that are not available to

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others. These concessions are provided to promote or deter particular behavior. As noted in PSC Study 10 *Definition and Recognition of Expenses/Expenditures*, paragraph .087, tax expenditures are forgone revenue, consequently they are not expenses incurred by the entity.

- 3.25. ***Expenses paid through the tax system*** are items that are available to beneficiaries regardless of whether or not they pay taxes. Some beneficiaries will receive the payment through the tax system as a reduction in the amount of income tax installments withheld from their wages or salary, others will receive it in another form, for example by check or electronic payment, or a cash payment from a benefit office. 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 – these child benefits are available whether or not a beneficiary pays income tax through the wage and salary withholding system.
- 3.26. The key distinction between tax expenditures and expenses paid through the tax system is that for tax expenses, the benefit is available to entities irrespective of whether they pay taxes, or use a particular mechanism to pay their taxes. The majority view of Steering Committee is that, in respect of tax expenses, the form of the payment should not influence the amount of revenue recognized, therefore revenue should be increased by the amount of the expense and an expense recognized for the same amount.

Preliminary View

7. ***In relation to taxes, offsetting of revenue and related expenses should not be permitted.***
8. ***Tax expenditures are foregone revenue, they are not expenses incurred by the entity.***
9. ***Expenses paid through the tax system are expenses incurred by the entity and should be recognized as expenses in the statement of financial performance. Tax revenue should be***

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adjusted for the amount of any expenses paid through the tax
system.***

The Right to Tax

- 3.27. Some argue that the “right to tax” is an intangible asset that should be recognized in the general-purpose financial statements of a public sector entity. The PSC has not issued an IPSAS on accounting for intangible assets. IPSAS 1, paragraph 42(c) establishes a hierarchy of guidance that entities can use in preparing general-purpose financial reports. The hierarchy includes pronouncements by the International Accounting Standards Board. The IASB has issued International Accounting Standard IAS 38 *Intangible Assets*. IAS 38 permits entities to initially recognize intangible assets at cost. Subsequent to initial recognition intangible assets should be measured at cost less accumulated amortization and impairments, or at fair value less accumulated amortization and impairments. In respect of intangible assets IAS 38 requires that fair value be determined by reference to an active market for the intangible asset. The IASB has an active project to review this IAS and in the context of its project on Impairment of Assets is considering the possibility of substituting the requirement to amortize intangible assets with a requirement to review the carrying amount of intangible assets for impairment at each reporting date.
- 3.28. The “right to tax” is normally established by a jurisdiction’s constitution, which will also establish a variety of other rights and duties of the government. The costs of establishing the right to tax are unlikely to be material. There is no active market in any jurisdiction for the “right to tax”; therefore, the fair value method permitted under IAS 38 cannot be used for measurement subsequent to initial recognition. Some jurisdictions have “securitized” certain of their tax revenues, however, this process does not involve selling to the purchaser of the security the right to levy and collect taxes. The Steering Committee is of the view that the right to tax cannot be recognized as an asset because it is not possible to establish the cost or fair value of the asset; therefore it fails the criteria for recognition as an asset.

Chapter 4 Transfers – Including Appropriations and Grants

Introduction and Definitional Issues

- 4.1. In chapter 1 it was explained that in this ITC the term “transfer” refers to non-exchange transactions other than taxes. In this chapter the term *contributor* is used to refer to the entity making a transfer. The term *recipient* is used to refer to the entity receiving the transfer.

Appropriations

- 4.2. **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. Appropriations may result in transfers, because one public sector entity, normally the central government entity, is authorized to transfer control of resources to another, normally a controlled public sector entity without specifying performance in exchange. Appropriations are frequently termed “current” or “capital”, however a variety of other names may also be used. These names may indicate that the contributor is restricting the recipient’s use of the resources in a specified manner. For example, in a particular jurisdiction a “capital appropriation” might require the recipient to acquire property, plant and equipment with the resources appropriated.
- 4.3. 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/equity 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, cash will be transferred to bank accounts controlled by individual public sector entities, which will then authorize and process their own payments.

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- 4.4. **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. Grants may be in the form of a payment in one reporting period or in a stream of payments over several reporting periods.
- 4.5. 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 them. 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. For example, a government may provide grants to a public sector university to fund the education of undergraduates.

Stipulations

- 4.6. In many cases, assets are transferred to public sector entities in a non-exchange transaction subject to stipulations that they be used for particular purposes and/or within particular time periods. This is frequently the case for transfers (including grants):
- (a) from national governments to provincial/state or local governments;
 - (b) 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; and.
 - (c) from donor agencies to governments or other public sector entities.
- 4.7. Stipulations often require a specific action or event to occur before the reporting entity is authorized to use the transferred resources. To satisfy the meaning of stipulations as used in this

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ITC, the restrictions, conditions and/or time requirements will need to be reflected in:

- (a) explicit agreements with the contributor who transfers the resources to the recipient, or
- (b) legislation enacted by the contributor government, where resources are transferred to the reporting entity by another government or an entity controlled by that government.

Application of Flowchart to Transfers

A. Does the inflow result from a “contribution from owners”?

- 4.8. A transfer, such as an appropriation, may be designated as a “contribution from owners”. If the transfer meets the definition of a “contribution from owners”, and satisfies the recognition criteria established in paragraphs 2.4 to 2.8, then that transfer should be recognized as a “contribution from owners” and not as revenue.

B. Is the transaction a non-exchange transaction?

- 4.9. Transfers dealt with in this chapter are non-exchange transactions because the recipient entity does not provide the contributor with goods or services of approximately equal value directly in exchange for the transfer.
- 4.10. Some jurisdictions establish “appropriations” in such a manner that the recipient entity is required to perform agreed or contracted services in exchange for their appropriated resources. In such circumstances, an analysis of the substance of the arrangement may lead the entity to conclude that it has entered into a transaction for the sale of services. If that is the case, entities need to determine if the sale results in an exchange at approximately fair value or at other than approximately fair value. If the exchange is at fair value, the transaction should be recognized according to the requirements of IPSAS 9. If the sale occurs at other than fair value, the discussion in paragraphs 5.2 to 5.11 is relevant.
- 4.11. Many grant agreements require the recipient of the grant to perform agreed or contracted services in exchange for the granted resources. In such circumstances, an analysis of the substance of the arrangement may lead the entity to conclude

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that it has entered into a transaction for the sale of services. If that is the case, entities need to determine if the sale results in an exchange at fair value or at other than fair value. If the exchange is at fair value, the transaction should be recognized according to the requirements of IPSAS 9. If the sale occurs at other than fair value, the discussion in paragraphs 5.2 to 5.11 is relevant.

C. Does the inflow give rise to an item that meets the definition of an asset?

Control of an Asset

4.12. Many transfers, particularly grants, are subject to detailed written agreements, which specify when the recipient will receive resources, how those resources are to be utilized, and how the recipient is to account to the contributor for those resources. The recipient 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 assets in relation to the transfer. However, when stipulations are attached, there are differing views on how those stipulations affect the recognition of receivables.

4.13. Some argue that the existence of stipulations will not influence when an asset should be recognized. They explain that, for example, an asset should be recognized:

- (a) if a provider has a long-standing practice of announcing transfers, and then providing those resources in accordance with a standard agreement, and
- (b) recipients believe that announcement of the transfer would enable the entity to recognize a receivable when the transfer is announced.

An associated stipulation should have no bearing on the timing of the recognition. (They also explain that their view would not change if the asset were not recognized until the transfer agreement was executed.) They base their view on the fact that the existence of the stipulation will not prohibit the entity from using or otherwise benefiting from the asset in pursuit of its objectives.

4.14. Others argue that stipulations contained in grant and other transfer agreements significantly limit the ability of the recipient to use or otherwise benefit from the future economic benefits or

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service potential represented by the receivable. They note that in some jurisdictions transfers that are announced often do not materialize because the contributor and recipient are unable to agree to the terms of a proposed transfer agreement or because once an agreement has been reached, the recipient does not meet stipulation requirements that will result in the transfer. They believe that:

- (a) the recipient reporting entity should not recognize a receivable or other asset and an increase in net assets/equity resulting from the transfer until the stipulations have been met; and
- (b) announcements of cash grants or other transfers when accompanied by stipulations are analogous to a pending order or signing of a purchase contract in the private sector. The reporting entity does not have a receivable until the terms of the contract (stipulations) have been met.

4.15. In resolving this matter the entity will need to consider, for example:

- (a) whether an appropriation subject to stipulations results in the recipient gaining control of resources;
- (b) whether past practice and the ongoing relationship with a contributor means that the announcement of a grant almost invariably results in the recipient gaining control of the granted assets; and
- (c) whether resources committed under multi-year funding agreements are controlled by the recipient.

Making an assessment of whether an asset is controlled in such circumstances and a receivable can be recognized will require entities to consider the nature of the stipulations and all the related circumstances, and exercise judgment to determine whether the definition of an asset is met.

4.16. Stipulations attached to property, plant and equipment and other productive assets may mean that, when an entity assesses all the facts of the situation, including the stipulations attached, it judges that it does not have sufficient control over the item to enable the definition of "asset" to be met. Control arises when the recipient has the authority to deploy the asset in achieving its objectives, within the parameters established by any stipulations. The definition of control of an asset also requires

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that the entity be able to exclude or regulate the access of others to the asset. 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 objectives and can exclude or regulate the access of others to that benefit. If the fair value of the asset can be reliably measured at this time, the criteria for recognition as an asset will also be satisfied.

Preliminary View

- 10. Determining when an inflow of resources that is subject to stipulations, results in the control of an asset will be a matter of judgment based on the nature of the stipulations and the circumstances facing the entity.***

Preliminary View

- 11. Transfers of resources that are subject to stipulations will meet the definition of an asset of the recipient entity when the entity can use or otherwise benefit from the assets in pursuit of its objectives and can exclude or regulate the access of others to those benefits.***

Cash

- 4.17. Some argue that cash transferred to a recipient subject to stipulations is not always controlled by the recipient. They are of the view that this is particularly so where those stipulations specify that the cash is to be transferred to third parties or otherwise provide the recipient with little discretion in the use of those resources, and that the interest earned be used for the benefit of third parties. They argue that in these circumstances:
- (a) the recipient does not control the cash and cannot exclude or regulate the access of others (being the designated third party) to that benefit; and therefore
 - (b) the recipient is acting in the capacity of an agent.
- 4.18. Others argue that cash transfers that are subject to stipulations and are deposited in a bank account controlled by the recipient are controlled by the recipient entity. This is because the recipient can benefit from the use of those resources through their deployment as specified in the stipulation. They also note that stipulations that the interest earned is to be provided to third

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parties indicate that the entity has an obligation to transfer an amount equivalent to that interest to those third parties, not that it does not control the cash generated from the interest. In these circumstances, the recognition criteria will also be satisfied because future economic benefits or service potential will flow to the entity and the amount of the transfer can be measured reliably. The majority view of the Steering Committee is that this view is consistent with that adopted for “control of cash” in the Cash Basis IPSAS *Financial Reporting Under the Cash Basis of Accounting*, and should also be adopted for this ITC.

Preliminary View

- 12. *Cash transfers that are subject to stipulations and which are deposited in a bank account controlled by the recipient are, in fact, controlled by the recipient.***

Other Assets

- 4.19. In certain cases a contributor will continue to hold title to an asset (for example, property) the use of which has been transferred to the recipient entity subject to certain stipulations. In other cases, title is passed; however, the use of the asset is dictated by stipulations.

Past Event

- 4.20. Determining when a transfer results in an inflow of resources will be a matter of judgment based on the facts. The point at which an inflow can be recognized as an asset will depend upon the circumstances facing the reporting entity. In some jurisdictions, for example, an appropriation may result in a recipient entity having the 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 expending of resources will result in an inflow to the reporting entity.
- 4.21. For most grants, the past event which gives rise to the control of an asset will be the agreeing of the terms of the grant between the contributor and recipient. However, the stipulations contained in such agreements may limit the ability of the recipient to recognize assets, and/or may require the recipient to recognize liabilities in respect of the grant.

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- 4.22. In many cases laws or transfer agreements will not give the recipient control over assets until the receipt of cash or another asset. These types of laws and agreements often specify that the recipient must meet eligibility criteria, that is satisfy certain stipulations, before assets will be transferred. In such circumstances the recipient reporting entity will analyze the agreement in light of the proposals on stipulations in this chapter to determine when a net increase in assets and revenue are to be recognized.

Central Bank Accounts

- 4.23. 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, explains that where there is a central bank account, individual public sector entities do not control the cash in that account.
- 4.24. In some jurisdictions, appropriations arrangements specify that when the entity incurs expenditure in accordance with its appropriation and the spending guidelines established by the government, it has the right to have its liabilities settled by the department of finance. In these circumstances the past event is the incurrence of the expenditure. Accruing revenue when entities incur expenditure means that entities can incur expenditures and recognize assets and revenue in one period but submit requests for payment to the department of finance in the subsequent period.
- 4.25. In other jurisdictions the entity does not have a right to have its liability settled by the department of finance until the department of finance has approved the expenditure and processed the payment. This circumstance makes no assumption about whether the entity has complied with its appropriation and the spending guidelines. A result of this circumstance is that if the department of finance delays payments at the end of the reporting period, the entity may recognize revenue in a

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subsequent period that should be recognized in the actual reporting period.

Third Party Settlements

- 4.26. Third party settlements occur when a contributor pays costs directly rather than provide monetary assets to the recipient reporting entity. This situation commonly occurs in the public sector when a contributor is providing aid to a public sector entity, for example, meeting half the costs of constructing a hospital. When the contributor makes payments on behalf of the recipient, the recipient does not control the funds payment. The inflow of resources would be recognized when the recipient entity assumes control of the underlying asset.

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

Probable Inflow of Resources

- 4.27. As noted in paragraph 4.12, many transfers are subject to detailed written agreements. When these agreements are executed the recipient will be in a position to judge if an inflow of resources embodying future economic benefits or service potential is probable.

Reliable measurement

- 4.28. Where transfers are received in the form of cash, measurement is not a significant issue. Where transfers are received as non-monetary assets, then the entity will need to determine the fair value of the assets being transferred. 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 section F below) at fair value as at the date of acquisition. Fair value may be determined by reference to the cost to the contributor if that is known, or by a valuation.

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E. Has the entity satisfied all outstanding obligations related to the inflow?

- 4.29. Transfers result in an inflow of future economic benefits or service potential to the government, as stated above. If this inflow is received without stipulations it does not result in the recipient entity incurring a liability to provide either goods or services directly to the contributor in exchange for the resources. Consequently, the recipient will recognize revenue for the increase in net assets/equity immediately. Transfers that are received with stipulations are discussed below.

F. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity, to the extent that a liability is not also recognized.

- 4.30. Under the approach proposed in this ITC, revenue from non-exchange transactions will be recognized when the entity recognizes assets and does not at the same time recognize an increase in liabilities of an equivalent amount. For a liability to arise at the time the entity recognizes an asset, the stipulations associated with the transfer must give rise to a present obligation for the recipient to sacrifice resources to another party, and the recipient must have no realistic alternative but to make that sacrifice. The amount of revenue from non-exchange transactions recognized would be the fair value of the inflow of resources recognized as assets, less any amount to be recognized under the provisions of another IPSAS (see paragraph 2.31 and Preliminary View 4).
- 4.31. Some argue that when the recipient recognizes transferred assets and it is not probable that the stipulations will be breached; the amount of those assets should be recognized as revenue. They argue that all assets provided to public sector entities are subject to stipulations that they be used appropriately. However, those stipulations do not give rise to a liability until such time as it is probable that they will be breached and a penalty will be imposed on the reporting entity.
- 4.32. Others argue that the distinction between restrictions and conditions is critical to the assessment of when revenue should be recognized. They are of the view that if the definition of an asset is met and the criteria for recognition as an asset are satisfied, revenue should be recognized:

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- (a) immediately the recipient gains control of transferred assets which are subject to restrictions – because recognizing the assets increases the net assets/equity of the entity; and
 - (b) in respect of transferred assets subject to conditions, only to the extent that those conditions are satisfied – because recognizing 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/equity of the entity is increased and revenue should be recognized.
- 4.33. Those who support this position believe that the recipient has an obligation to the contributor based on the stated conditions that can only be settled through an outflow of service potential (satisfying the stipulations) or an outflow of economic resources (refunding those resources to the contributor). Unlike unconditional resources received by the reporting entity, some form of outflow must occur before the obligation is discharged.
- 4.34. Still others argue that a recipient of transferred assets, which are subject to stipulations, should not recognize revenue until such time as the recipient has discharged the stipulations have been satisfied. Supporters of this view argue that the recipient should recognize a liability to reflect the obligation imposed by the stipulation and recognize revenue as those stipulations are discharged. They argue that the obligation that must be settled through the outflow of service potential is in substance the same whether the stipulation is a restriction or a condition.

Restrictions

Definition from paragraph 1.19

Restrictions are stipulations that limit or direct the purposes for which transferred assets may be used, but do not specify that the assets must be returned to the contributor if not deployed as specified.

- 4.35. 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

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- (b) do not require the asset to be returned to the contributor 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 sacrifice future economic benefits or service potential to another party. However, a present obligation to sacrifice 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.

Preliminary View

- 13. An entity that recognizes transferred assets that are subject to restrictions should recognize revenue in respect of those assets immediately.***

Conditions

Definition from paragraph 1.19

Conditions are stipulations that specify that transferred assets must be returned to the contributor if not deployed as specified, or if a specified future event occurs or does not occur.

Assets to be transferred to Third Parties

- 4.36. The Steering Committee is of the view that an asset and a liability should be recognized in respect of transfers of monetary and non-monetary assets that are subject to conditions that require the recipient entity to transfer the assets to third parties or otherwise return the assets to the contributor. This is because the recipient gains control of the asset but also has no realistic alternative but:
- (a) to sacrifice those assets, by transferring them to third parties in accordance with the conditions related to the provision of the assets by the contributor; or
 - (b) to return the assets to the contributor if the conditions are breached.

Preliminary View

- 14.** *A recipient should recognize a liability in respect of inflows of resources recognized as assets that are transferred subject to conditions. The liability should be reduced and revenue recognized as the conditions are satisfied.*

Monetary Assets to be used in the Provision of Goods and Services

- 4.37. The Steering Committee is of the view that transfers of monetary assets subject to conditions that they be deployed in the provision of goods or services as specified or be returned to the contributor would also give rise to an asset and a liability. This is because recognizing monetary assets subject to such conditions gives rise to a present obligation to sacrifice assets 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 sacrificed to the ultimate recipients; or
 - (b) return the monetary assets to the contributor.

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

- 4.38. As 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 conditions and their settlement, for example where a liability is recognized when monetary assets are transferred on condition that they:
- (a) are used to deliver goods and services as specified and are to be returned to the contributor if not deployed as specified – the liability will be discharged as those goods and services are provided;
 - (b) be expended in the acquisition of non-current assets and are to be returned to the contributor if not deployed as specified – the liability will be discharged when the non-current assets are acquired;

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- (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 contributor if such a contribution is not made – the liability will be discharged when the matching contributions are made or it becomes probable that they will be made; and
 - (d) in the case of cash provided on the condition that it be invested to form a permanent endowment and is to be returned if such an endowment is not established – the liability will be discharged when that cash is invested consistent with the conditions imposed by the contributor.
- 4.39. 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 sacrifice 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.

Preliminary View

15. ***Monetary assets transferred subject to conditions should be recognized by the recipient as assets and as revenue, except to the extent that a liability is recognized in respect of those conditions.***

Non-Monetary Assets to be used in the Provision of Goods and Services

- 4.40. In some circumstances non-monetary assets may be transferred to a recipient entity subject to conditions that they be used in the provision of goods and services for third parties; or be returned to the contributor.
- 4.41. Some argue 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. This is because there is no clear statement of specific actions that are to be taken and that give rise to a present obligation to sacrifice future economic benefits or service potential represented by the asset. They are of the view that 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

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parties as a consequence of a 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 recipient having no realistic alternative to transferring resources to another party, whether the contributor or a third party. Rather it is a subsequent event that is the obligating event.

- 4.42. The Steering Committee is of the view that there is no substantive difference between the future economic benefits or service potential represented by non-monetary assets such as property, plant and equipment or monetary assets. Therefore, the Steering Committee has reached the same conclusion in respect of non-monetary assets and monetary assets. That is, transfers of non-monetary assets¹ subject to conditions that they be deployed in the provision of goods or services as specified or returned to the contributor would initially give rise to an asset and a liability of similar amount. This is because the entity has no realistic alternative but to:

- (a) sacrifice resources to third parties as the non-monetary assets are consumed in generating services for, or in producing goods that will be distributed to, third parties in accordance with the stipulations; or
- (b) return the assets to the contributor where those stipulations are breached.

Preliminary View***16. Non-monetary assets transferred subject to should be recognized by the recipient as assets and revenue, except to the***

¹ 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 contributor 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 contribution, is obligated to sacrifice 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 contribution, and revenue will be recognized as the conditions are satisfied. Where there is no obligation to return the assets to the contributor 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.

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extent that a liability is recognized in respect of those
conditions.

The Substance of the Transfer

- 4.43. The Steering Committee is concerned to ensure that the mere form of a transfer subject to conditions, 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 satisfy the criteria 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 contributor 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; and
 - (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.

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Definition from paragraph 1.19

Time requirements are stipulations that prohibit the use of transferred assets until a specified point in time.

- 4.44. In the public sector, transfers (usually in the form of cash or a right to receive cash) are frequently made subject stipulations that the transferred assets are to be used in particular time periods. Transfers subject to time requirements as considered in this section are distinguished from those that are in the nature of an exchange transaction and specify that the contribution be made to provide particular goods or services to or on behalf of, the contributor in a particular future period. Transfers that are in the nature of an exchange transaction should be accounted for according to the requirements of IPSAS 9.
- 4.45. In many jurisdictions, entities enter multi-period agreements for the transfer of resources, which commit a contributor to transferring resources to a recipient over several reporting periods. These transfers are normally subject to time requirements and/or conditions that require the recipient to achieve stated objectives before qualifying for the next installment.
- 4.46. Some are of the view that, in respect of transfers that are subject to time requirements, the recipient entity should recognize revenue immediately the entity recognizes the asset that arises from such transfers. They argue that such stipulations will not give rise to liabilities when the entity recognizes the transferred assets. This is because at the time the recipient gains control of the transfer a present obligation to sacrifice the transferred asset to a third party, or to return it to the contributor, does not arise.
- 4.47. Others argue that time requirements are such that when the entity recognizes the transferred assets, an obligating event occurs that requires the recipient entity not to use the transferred assets except in the time periods specified. Consequently revenue should only be recognized as that obligation is discharged and the time requirements are satisfied – that is, in the time period in which the use of the assets is no longer

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prohibited. They note that while the nature of the obligation that arises from time requirements does not satisfy the definition of a liability as specified in IPSASs:

- (a) the entity cannot benefit from the majority of the future economic benefits or service potential represented by the transferred assets until the time period in which use of the assets is authorized;
- (b) the future economic benefits or service potential that can be enjoyed by the recipient on initial recognition of the transferred assets are those net of the prohibition imposed by the time restriction; and
- (c) this is best reflected in general-purpose financial reports by recognizing a time requirement as a liability in the same way as a prepayment of an exchange transaction is recognized as a liability.

They also note that this is consistent with comprehensive and transparent financial reporting of the resources controlled by the entity, and with Preliminary View 12 which reflects the view that amounts deposited in a bank account controlled by the reporting entity are controlled.

- 4.48. The Steering Committee is of the view that where the timing requirements are such that an entity is prohibited from utilizing the recognized assets until a specified time period, the time requirement should be deemed a liability and the entity should be required to recognize a liability in respect of those assets. An item would normally need to meet the definition of a liability, and satisfy the criteria for recognition as a liability before it could be recognized as such, however in the case of time requirements, the Steering Committee is of the view that a liability should be deemed to exist. When the liability is recognized, revenue would be recognized when that liability is discharged, that is when the time requirement is satisfied. In determining whether an obligating event has occurred that requires the entity to recognize a liability, the entity will exercise judgment based on the facts and the nature of the time requirements imposed upon it.

Preliminary View

17. ***A recipient should recognize a liability in respect of inflows of resources recognized as assets that are transferred prior to the***

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time period in which use of those resources is authorized. The liability should be reduced and revenue recognized when the time requirements are satisfied.

G. Recognize an asset at fair value and recognize revenue, for the increase in net assets/equity

- 4.49. Where there are no externally imposed stipulations on the use of transferred assets, the reporting entity will recognize revenue for the increase in net assets/equity experienced as a result of a transfer transaction, less any amount to be recognized under the provisions of another IPSAS as proposed by paragraph 2.31 and Preliminary View 4.

Preliminary View

- 18. *Transfers, including grants and those arising from appropriations, are non-exchange transactions and, to the extent that a liability is not recognized, 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/equity;***
- (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.***

Presentation of Revenue

- 4.50. Some are of the view that under some circumstances a reporting entity should present transfer revenue net of expenses required under the conditions of the transfer. 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.
- 4.51. The Steering Committee is of the view that there is no characteristic of transfer 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 on the face of the statement of financial performance. This point was also made in paragraph 3.23 in respect of tax revenue.

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- 4.52. 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 View

19. *In relation to transfers offsetting of revenue and related expenses should not be permitted.*

Chapter 5 – Other Revenue

- 5.1. This chapter discusses classes of non-exchange revenue other than taxes, grants and appropriations and presents preliminary views on when and what amounts should be recognized in the general-purpose financial statements.

Non-Exchange Transactions in which some consideration is exchanged

- 5.2. 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. Such transactions can include:
- (a) the purchase of property, plant and equipment at subsidized prices;
 - (b) the sale of medical services at subsidized prices;
 - (c) the provision of loans at subsidized interest rates;
 - (d) the provision of housing at subsidized rentals; and
 - (e) the provision of education services at subsidized prices.
- 5.3. For many public sector entities, engaging in such transactions does not result in an increase in net assets/equity. This is because the carrying value of the assets given up exceeds the fair value of the assets received – these transactions do not generate revenue from non-exchange transactions. However, where a public sector entity is the purchaser of a subsidized good, the fair value of the asset acquired may be greater than the carrying amount of the assets given up. Entities would need to apply the approach proposed in this ITC to these classes of transactions. This is illustrated in paragraphs 5. to 5. below.

Preliminary View

20. *Where entities provide or acquire goods or services in a non-exchange transaction and there is an increase in net assets/equity, the inflowing assets should be recognized at their fair value. The consideration provided should be*

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recognized according to the provisions of the relevant International Public Sector Accounting Standard. The entity should recognize the increase in net assets/equity as revenue from a non-exchange transaction.

Debt Forgiveness/Assumption of Liabilities

- 5.4. In the public sector lenders will sometimes waive their right to collect a debt owed by an 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/equity, because a liability it previously owed is now extinguished.
- 5.5. Some argue that these transactions should be recognized as a direct contribution 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.

Preliminary View

21. ***Where a creditor cancels liabilities, or another entity assumes liabilities, the debtor entity should recognize the decrease in the carrying amount of liabilities as revenue in the period in which the decrease is recognized.***

Voluntary Services

- 5.6. 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

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entities can also receive unpaid services from offenders as part of a punishment imposed by a court.

- 5.7. Some argue that entities should measure the fair value of all voluntary services provided to the reporting entity and recognize that amount as both revenue and an expense in the general-purpose financial statements. They argue that the reporting entity should also make disclosures about the nature of the voluntary services and the method used to determine the fair value of those services. This approach enables entities to recognize the full cost of providing its services during the reporting period. Disadvantages of this approach are that many services provided to a reporting entity are not of the type 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.
- 5.8. Others argue that entities should 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.
- 5.9. Still others argue that entities should not recognize voluntary services in the statement of financial performance, but rather 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.

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- 5.10. The Steering Committee is not convinced that voluntary services meet the definition of an asset. This is because entities do not have sufficient control over the services that volunteers provide for them to meet the definition of “control of an asset”. The Steering Committee also notes that to require entities to recognize all voluntary services at fair value would require considerable cost to entities, and the benefits achieved may not warrant such a cost. The Steering Committee recognizes, however, that voluntary services can make a considerable contribution to the financial performance and position of an entity. It recommends that entities disclose in the notes to the general-purpose financial statements, the extent to which voluntary services contributed to the entity’s financial performance, position and cash flows where such a contribution can be measured reliably.

Preliminary View

22. ***Voluntary services should not be recognized as assets or revenue in the statement of financial performance, disclosures about the general nature of voluntary services received should be made.***

Pledges

- 5.11. 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 a receivable and revenue. Paragraphs 4.12 to 4.15 discuss when an entity can recognize a receivable, that discussion is also applicable to pledges. If a pledge has stipulations attached, entities need to consider whether these require the recognition of liabilities as indicated in Chapter 4. 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 is of such repute that when the pledge is made, it will be probable that an inflow of resources to the reporting entity will occur, in case the pledge may meet the definition of an asset and satisfy the criteria for recognition as an asset.

Preliminary View

23. *Pledges should be recognized as assets and revenue when the inflow of resources meets the definition of an asset and satisfies the criteria for recognition as an asset.*

Gifts, Donations and Bequests

- 5.12. 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 giving rise to the control of a resource 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 4.

Preliminary View

24. *Gifts and donations should be recognized as assets and revenue when the inflow of resources meets the definition of an asset and satisfies the criteria for recognition as an asset.*

Fines

- 5.13. 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. The paragraphs below illustrate the application of the approach adopted in this ITC to fines.

Preliminary View

25. *Fines should be recognized as assets when the amount receivable meets the definition of an asset and satisfies the criteria for recognition as an asset, and revenue should be recognized for the same amount.*

Application of the Flowchart to these Transactions

A. Does the inflow result from a “contribution from owners”?

- 5.14. Debt forgiveness is not a “contribution from owners” unless the former creditor has an ownership interest in the debtor entity and has formally designated the forgiveness as a contribution from owners in accordance with paragraph 2.7.
- 5.15. The other types of transactions are not “contributions from owners”.

B. Is the transaction a non-exchange transaction?

- 5.16. The transacting entities are not exchanging approximately equal value in these transactions so the transaction is a non-exchange transaction.

C. Does the inflow give rise to an item that meets the definition of an asset?

- 5.17. Where the entity receives an inflow or resources, those resources need to meet the definition of an asset. Normally, the consideration received will be cash and will satisfy the definition of an asset, if it is paid into a bank account controlled by the entity. The entity will use judgment to determine whether items satisfy the definition of an asset.
- 5.18. In the case of debt forgiveness, the inflow of resources will not meet the definition of an asset. However, the inflow of resources does result in an item no longer meeting the definition of a liability. As a result that liability will be derecognized and an increase in net assets/equity will occur. This possibility is noted in a footnote to the flowchart in chapter 2.

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

- 5.19. Where the entity receives a cash payment for subsidized goods or services the recognition criteria will be met. Where the entity receives another asset, the entity will refer to the commentary in Chapter 2 and the requirements of the IPSASs to determine if the recognition criteria are met.
- 5.20. In the case of debt forgiveness the inflow of resources results in an item no longer satisfying the criteria for recognition as a liability, rather than satisfying the criteria for recognition as an asset.

E. Has the entity satisfied all outstanding obligations related to the inflow?

- 5.21. The entity needs to determine if it has satisfied all its obligations in relation to the inflow. For example, it needs to determine if it has provided the goods or services, or, if it is a purchaser, the consideration.
- 5.22. In relation to debt forgiveness, the creditor has forgiven the debt. As such, the debtor no longer has any obligations in relation to the debt.

F. Recognize an asset at fair value and recognize revenue for the increase in net assets/equity, to the extent that a liability is not also recognized.

- 5.23. Where an entity has not satisfied its obligations it needs to determine if it should recognize a liability in respect of part of, or the entire, outstanding obligation. Entities will refer to IPSAS 19, and chapters 2 and 4 of this ITC to determine if the obligation meets the definition of a liability and satisfy the criteria for recognition as a liability. An entity should recognize revenue for the increase in net assets/equity to the extent that a liability is not also recognized.
- 5.24. In relation to debt forgiveness, unless the transaction imposes a condition or a time requirement on the entity, the entity will not recognize a liability.

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- G. Recognize an asset at fair value and recognize revenue for the increase in net assets/equity, to the extent that a liability is not also recognized.**

- 5.25. When an entity has satisfied all outstanding obligations then it will recognize the inflowing asset at its fair value, and revenue from non-exchange transactions for the difference between the fair value received and the carrying amount of the consideration provided. The consideration should be recognized as if that portion of the transaction were an exchange transaction. For example, if the entity received 100 currency units, and gave up inventory with a carrying value of 10, the entity would recognize an increase in cash of 100 currency units, it would recognize revenue from a non-exchange transaction of 90 currency units, and it would recognize the remaining 10 currency units according to the requirements of IPSAS 12 *Inventories*.

Chapter 6 Implications for IPSAS 9

- 6.1. International Public Sector Accounting Standard IPSAS 9 *Revenue from 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”. The commentary in IPSAS 9 was used by the Steering Committee to develop the definitions of “exchange transactions” and “non-exchange transactions”.
- 6.2. 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.
- 6.3. The most marked difference between IPSAS 9 and this ITC is a move away from an outflow or earnings type approach to an 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.
- 6.4. Another marked difference between the approach adopted in this ITC and IPSAS 9 is the focus on measuring assets 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.
- 6.5. As was stated in Chapter 1, the IASB has begun a project to review IAS 18 with a view to issuing an IFRS more in conformity with its *Framework for the Preparation and Presentation of Financial Statements*. The IASB is adopting an assets and liabilities approach, as has been adopted in this

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ITC. This ITC proposes that the exchange component of non-exchange transactions be accounted for by reference to the relevant standard for exchange transactions. The IASB project and this ITC appear to be adopting similar approaches. 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 the IASB *Framework* as its own, it has been influential in the development of this ITC.

- 6.6. The Steering Committee is of the view that there should, 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.
- 6.7. The Steering Committee is of the view that this ITC represents an important step in the evolution of a comprehensive IPSAS on revenue. The next step will be an Exposure Draft prepared in the light of comments received on this ITC and any Exposure Draft or International Financial Reporting Standard issued by the International Accounting Standards Board.

Preliminary View

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

Appendix– Examples of Revenue from Non-Exchange Transactions¹

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

Example 1: Income Tax

- A1.2. A national government (reporting entity) imposes a 25 percent tax on personal income earned within the country. Employers are required to withhold taxes from payroll and remit withholdings on a monthly basis. Individuals with significant non-salary (for example, investment) income are required to make estimated tax payments on a quarterly basis. In addition, individuals must file a tax return with the taxation department by 15 April of the year following the tax year (calendar year) and must pay the remaining tax owed (or claim a refund) at that time. The government's reporting period ends on 30 June.
- A1.3. The government controls a resource – income tax receivable – when the taxable event occurs, which is the earning of assessable income by taxpayers. The government should recognize the assets and revenue as taxpayers earn income, or as soon as it can reliably measure the asset.

Example 2: Value added tax

- A1.4. A national government (reporting entity) imposes a value added tax (VAT) on all businesses. The tax is 15 percent of the value added and is collected by merchants from customers (taxpayers) at the time of sale. Most businesses are required to submit VAT returns electronically to the tax department on a weekly basis; however, small businesses are permitted to submit VAT returns manually on a quarterly basis.
- A1.5. The government controls a resource – VAT receivable – when the taxable event occurs, which is the undertaking of taxable activity during the reporting period. The government should

¹ Some of the examples in this appendix are based on the examples in GASB Statement 33 *Accounting for Financial Reporting for Nonexchange Transactions*, Appendix D.

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recognize assets and revenue as the taxable activity takes place, or as soon as it can reliably measure the assets.

Example 3: Goods and Services Tax

- A1.6. A national government (reporting entity) imposes a goods and services tax (GST) on all businesses. The tax is 10 percent of the value of goods and services sold. Taxpayers are given “input credits” for the GST paid on input goods and services. GST is included in the price of all goods and services sold. Most businesses are required to electronically submit GST returns to the tax department on a weekly basis; however, small businesses are permitted to manually submit GST returns on a quarterly basis.
- A1.7. The government controls a resource – GST receivable – when the taxable event occurs, which is the purchase or sale of taxable goods and services during the reporting period. The government should recognize assets and revenue as the sales and purchases take place, or as soon as it can reliably measure the assets.

Example 4: Customs Duty

- A1.8. A national government (reporting entity) imposes customs duty on all imports of goods for which there is a domestically produced substitute. The duties vary depending on the type of goods imported, and are set at levels to ensure that the domestically produced goods are cheaper in the retail market. Imported goods are held in bonded warehouses until the importer pays the duty. Importers are required to make import declarations to the customs department, and pay the duty immediately. Most importers submit these declarations electronically before the goods arrive, and make electronic funds transfers to the customs department when the goods are unloaded from ships or aircraft, or as trains or trucks pass the customs boundary.
- A1.9. The government controls a resource – duty receivable – when the taxable event occurs, which is the movement of goods across the customs boundary. The government should recognize assets and revenue as the goods move across the boundary, or as soon as it can reliably measure the assets.

Example 5: Death Duties

- A1.10. A national government (reporting entity) imposes death duties of 40% on all estates valued at more than 500,000 currency units.

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Medical practitioners and funeral directors are required to notify the tax department of all deaths, an assessor then makes an interim valuation of the estate to determine whether duty will be payable. Executors of estates are required to file an inventory of the estate with the tax department, which values the estate and determines the duty due from the estate. Probate cannot be granted until all duty is paid. Due to complexities in testamentary law and frequent appeals of valuations, it takes on average, four years to settle estates and collect the duty due.

- A1.11. The government controls a resource – death duties receivable – when the taxable event occurs, which is the death of a person owning taxable property. The government should recognize assets and revenue as soon as a person dies, or as soon as it can reliably measure the assets.

Example 6: Property Tax

- A1.12. A local government (reporting entity) levies a tax of 1 per cent of the assessed value of all property within its jurisdiction. The government's reporting period is 1 July to 30 June. The tax is levied on 31 July, with notices of assessment being sent to property owners in July, and payment due by 31 August. If taxes are unpaid on that date, property owners incur penalty interest rate payments of three percent per month of the amount outstanding. The tax law permits the government to seize and sell a property to collect outstanding taxes. Experience has shown that the government will collect 98% of the amount levied by the due date.
- A1.13. The government controls a resource – property taxes receivable – when the taxable event occurs, which is passing of the date on which the taxes are levied – 31 July. The government should recognize assets and revenue on that date.

Example 7: Appropriation to Government Department

- A1.14. On 1 November 20X1 the legislature passes an appropriation bill that provides an appropriation of 100 million currency units to the Department of Education (reporting entity) for the year 1 January 20X2 to 31 December 20X2. The bill becomes an act (a law) on 1 January 20X2, when it is proclaimed by the government, the government can withdraw the bill before proclamation, and has done so on numerous occasions as circumstances change. The appropriation act includes a detailed budget for the Department of Education that requires that the

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Department only spend the appropriated amount as authorized or return it to the government. The government does not operate a central bank account; all government entities operate accounts at the central bank from which they authorize their own payments. Appropriated amounts are transferred to entity accounts when the appropriation bills are proclaimed.

- A1.15. The Department of Education should recognize appropriated amounts assets when they obtain control over those resources, which is when the appropriation bill is proclaimed, on 1 January 20X2. The stipulation to spend money only according to the approved budget is a condition, and a liability should be recognized in respect of this condition. The liability is discharged as the condition is satisfied, that is when the department spends according to its budget.

Example 8: Grant to another level of government for general purposes

- A1.16. The national government (contributor) makes a grant of 10 million currency units to a local government in a socio-economically deprived area. The local government is required under its constitution to undertake various social programs, however it has insufficient resources to undertake all of these programs without assistance. There are no conditions attached to the grant, however the national government has indicated that if the grant money is not used appropriately, the following year's grant will be reduced. All local governments are required to prepare and present audited general-purpose financial statements.
- A1.17. There are no stipulations attached to these grants, so the transfers should be recognized as assets and revenue as soon as they are received or receivable.

Example 9: Transfer to a public sector university with restrictions

- A1.18. The national government provides a transfer of 200 hectares of land in a major city to a university for the establishment of a university campus. The transfer agreement specifies that the land is to be used for a campus, but does not specify that the land be returned if not used for a campus.
- A1.19. The university should recognize the land as an asset when it obtains control of that land. The land should be recognized at its fair value. The restriction does not meet the definition of a liability, or satisfy the criteria for recognition as a liability,

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therefore the university should recognize revenue in respect of the land.

Example 10: Grant to another level of government with conditions attached

- A1.20. The national government (contributor) grants 10 million currency units to a province (recipient) to be used to improve and maintain mass transit systems. Specifically, the money is required to be used as follows: 40 percent for existing railroad and tramway system modernization, 40 percent for new railroad or tramway systems, and 20 percent for rolling stock purchases and improvements. Under the terms of the grant, the money can only be used as stipulated, and the province is required to include a note in its audited general-purpose financial statements detailing how the grant money was spent. The agreement requires the grant to be spent in the current year or be returned to the national government.
- A1.21. The province should recognize the grant money as an asset when it has agreed the terms with the national government and the grant is received or receivable. The province should also recognize a liability in respect of the condition attached to the grant. As the province satisfies the condition, that is as it makes authorized expenditures, it reduces the liability and recognizes revenue.

Example 8: Grant to another level of government with time requirements

- A1.22. The national government (contributor) grants money to five state governments (recipients) as its contribution to a joint national-state government health scheme. The grant agreement stipulates that the national government will transfer 100 million currency units in the first year, but the state governments may only spend one-seventh of the money each year. Any interest that accumulates must be spent in the year in which it is earned.
- A1.23. The states should recognize the inflow of resources as assets when they are received or receivable. They must also recognize liabilities for the time requirements. As time passes they reduce the amount of the liability and recognize revenue.

Example 9: Research Grant, in substance exchange transaction

- A1.24. A large corporation that makes cleaning products (contributor) gives money to a public university (recipient) to conduct

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research on the effectiveness of a certain chemical compound in quickly removing graffiti. The corporation stipulates that the research results should be shared with the corporation before being announced to the public, and that the corporation has the right to apply for a patent on the compound.

- A1.25. This is an exchange transaction. (In return for its “grant”, the corporation receives the right (future economic benefit) to profit from the research results.) IPSAS 9 *Revenue from Exchange Transactions* applies to this transaction.

Example 10: Debt forgiveness

- A1.26. The national government had lent a local government 20 million currency units to enable the local government to build a water treatment plant. After a change in policy, the national government decides to forgive the debt. There are no stipulations attached to the forgiveness of debt. The national government writes to the local government and advises of its decision; it also encloses the loan documentation, which has been annotated to the effect that it is not longer enforceable.
- A1.27. When it receives the letter and documentation from the national government, the local government derecognize the liability for the loan and recognize revenue.

Example 11: Purchase of property at a subsidized price

- A1.28. A public school purchases land with a fair value of 100,000 currency units for 50,000 currency units from a local government. The public school should recognize the land at 100,000 currency units, a reduction in its asset “cash” of 50,000 currency units and revenue from a non-exchange transaction of 50,000 currency units.

Example 12: Sale of inventory at a subsidized price

- A1.29. A public hospital sells prescription drugs to patients at a subsidized price. A drug that cost 10 currency units is sold for 12 currency units; the same drug is sold for 50 currency units in a nearby private hospital. The transaction is a non-exchange transaction with an exchange component. When the drug is sold the public hospital should recognize an increase in the asset cash of 12 currency units, revenue from the sale of goods of 10 currency units, revenue from a non-exchange transaction of 2 currency units, a decrease in the asset inventory of 10 currency units, and cost of sales expense of 10 currency units.

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Example 13: Pledge

- A1.30. A 25-year-old recent graduate (contributor) of a public university names the university (recipient) as the primary beneficiary in her will. This is communicated to the university. The graduate is single and has an estate currently valued at \$50,000.
- A1.31. The public university should not recognize any asset or revenue. It is not probable that the university will remain the primary beneficiary, and potential future distributions from the estate are reliably measurable at this time.

Example 14: Fine

- A1.32. A major corporation is found guilty of polluting a river. As a penalty it is required to clean up the pollution and to pay a fine of 50 million currency units. The company is in sound financial condition and is capable of paying the fine. The company has announced that it will not appeal the case. The government (reporting entity) should recognize a receivable and revenue of 50 million as soon as the fine is imposed.