



Revenue from exchange transactions (IPSAS 9) Revenue from non-exchange transaction - Taxes & Transfers (IPSAS 23)

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Presentation outline



1. Definition of terms
2. Key sources of exchange and non-exchange revenue
3. Measurement
4. Practical examples on how to account for exchange & non-exchange revenue
5. Key disclosure requirements
6. Practical Implementation challenges

Definition of terms



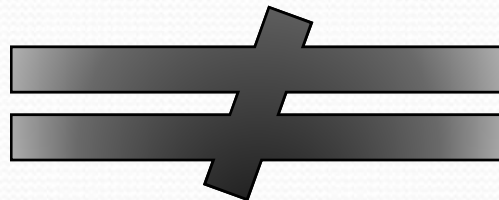
Exchange transactions – are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange .



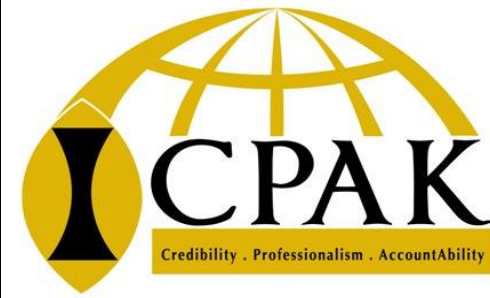
Definition of terms cont'd



Non-exchange transactions - are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.



Sources of Revenue from exchange transactions



Revenue includes only the gross inflows of economic benefits or service potential received and receivable by the entity on its own account.

Amounts collected as an agent of the government or another government organization or on behalf of other third parties; for example, the collection of driving licence fees, passport application fees, electricity/water/telephone bills payment, etc by the *HUDUMA CENTRE* on behalf of entities providing such services are not economic benefits or service potential that flow to the Postal corporation, and do not result in increases in assets or decreases in liabilities. **KRA** also collects levies such as ANSC and PSC on agency basis.

Instead, revenue is the amount of any commission received, or receivable, for the collection or handling of the gross flows.

Sources of Revenue from exchange transactions cont'd



Revenue is recognized when it is probable that;

- (a) future economic benefits or service potential will flow to the entity, and
- (b) these benefits can be measured reliably

Examples of **services** rendered by public sector entities for which revenue is typically received in exchange may include the provision of housing, management of water facilities, management of toll roads, and management of transfer payments.

Sources of Revenue from exchange transactions cont'd



Goods includes;

- (a) goods produced by the entity for the purpose of sale, such as publications, and
- (b) goods purchased for resale, such as merchandise or land and other property held for resale.

The **use by others of entity assets** gives rise to revenue in the form of:

- (a) Interest – charges for the use of cash or cash equivalents, or amounts due to the entity;
- (b) Royalties – charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights, and computer software; and
- (c) Dividends or similar distributions – distributions of surpluses to holders of equity investments in proportion to their holdings of a particular class of capital.

IPSAS 9 Cont'd

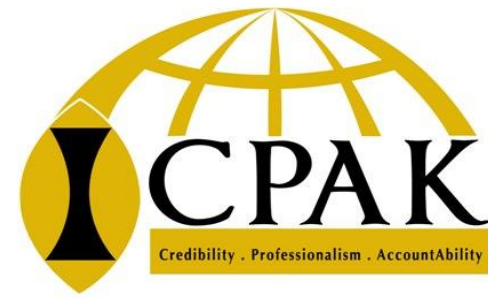


Financing inflows, notably borrowings, do not meet the definition of revenue because they;

- (a) result in an equal change in both assets, and liabilities and
- (b) have no impact upon net assets/equity.

Financing inflows are taken directly to the statement of financial position and added to the balances of assets and liabilities.

Measurement of exchange revenue



❖ Revenue shall be measured at the fair value of the consideration received or receivable.

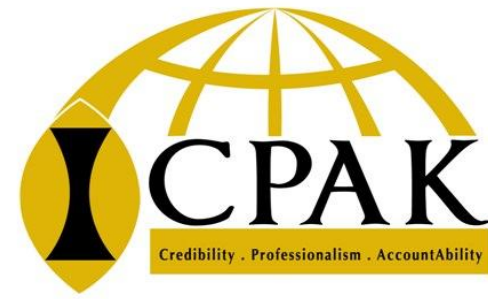
❖ The amount of revenue arising on a transaction is usually determined by agreement between the entity and the purchaser or user of the asset or service. It is measured at the fair value of the consideration received, or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the entity.

Measurement of exchange revenue



Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

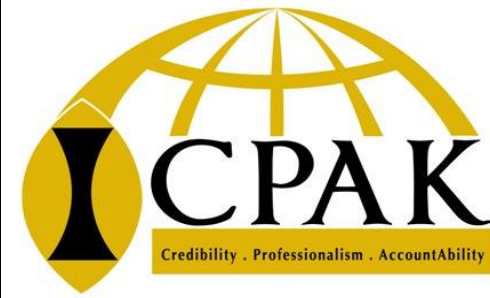
Measurement of exchange revenue



An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:

- a) Each party's enforceable rights regarding the service to be provided and received by the parties;
- (b) The consideration to be exchanged; and
- (c) The manner and terms of settlement.

Measurement of exchange revenue



The stage of completion of a transaction may be determined by the following methods;

- (a) Surveys of work performed;
- (b) Services performed to date as a percentage of total services to be performed; or
- c) The proportion that costs incurred to date bear to the estimated total costs of the transaction.

Note - when the outcome of a transaction cannot be estimated reliably, and it is not probable that the costs incurred will be recovered, revenue is not recognized and the costs incurred are recognized as an expense.

Revenue from sale of goods



Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied:

- (a) The entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;
- (b) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- (c) The amount of revenue can be measured reliably;
- (d) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and
- e) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Interest, Royalties, and Dividends or Similar Distributions



Revenue shall be recognized using the following accounting treatments:

- (a) **Interest** shall be recognized on a time proportion basis that takes into account the effective yield on the asset;
- (b) **Royalties** shall be recognized as they are earned in accordance with the substance of the relevant agreement; and
- (c) **Dividends** or similar distributions shall be recognized when the shareholder's or the entity's right to receive payment is established.

Disclosure



An entity shall disclose:

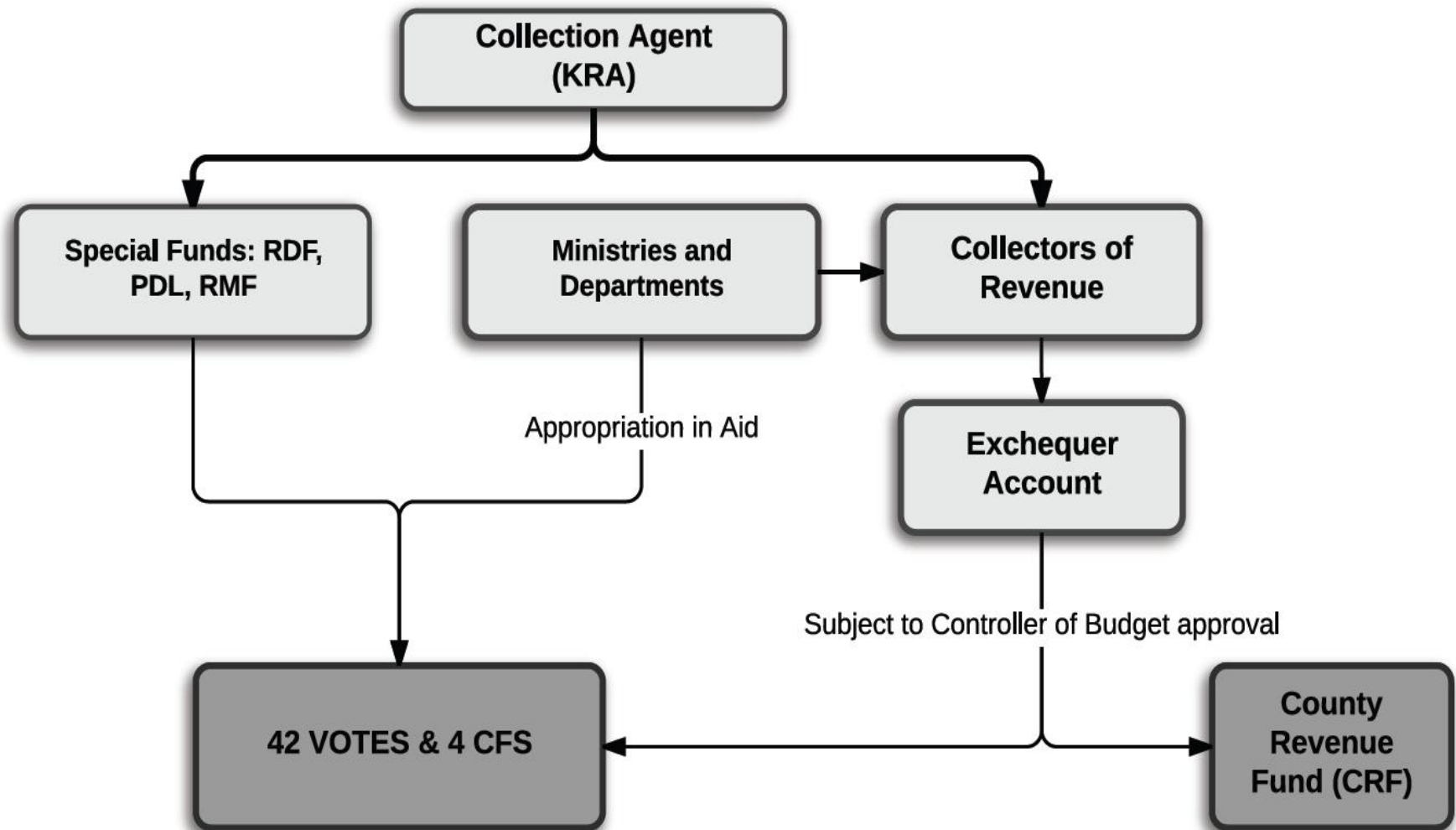
- (a) The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
- (b) The amount of each significant category of revenue recognized during the period, including revenue arising from:
 - (i) The rendering of services;
 - (ii) The sale of goods;
 - (iii) Interest;
 - (iv) Royalties; and
 - (v) Dividends or similar distributions; and
- (c) The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Implementation



Article 82 of the PFM Act 2012 requires that all National Government Receivers of Revenue to prepare a report on revenue collected during the year and submit to the Auditor-General and a copy to the Controller of Budget, National Treasury and the Commission on Revenue Allocation **by 30th September.**

Funds flow process (ref to sec 206 of the CoK)



Challenges



1. An accrual standard but some entities (e.g MDAs) are currently preparing reports on cash basis (receivers of revenues reports)
2. Data mismatch especially where entities like postal corporation (huduma centre) collect revenues as agents for others.
3. Re-structuring especially within state corporations especially where entities are merged with others or completely scrapped off

REVENUE FROM NON-EXCHANGE TRANSACTIONS – IPSAS 23



While revenues received by public sector entities arise from both exchange and non-exchange transactions, the majority of revenue of governments and other public sector entities is typically derived from non-exchange transactions, such as:

- (a) Taxes; and
- (b) Transfers (whether cash or noncash), including grants, debt forgiveness, fines, bequests, gifts, donations, goods and services in kind, and the off-market portion of concessionary loans received.

Definitions



Expenses paid through the tax system are amounts that are available to beneficiaries regardless of whether or not they pay taxes.

Fines are economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.

Tax expenditures are preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.

Definitions cont'd



The **taxable event** is the event that the government, legislature, or other authority has determined will be subject to taxation.

Taxes are economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and/or regulations, established to provide revenue to the government.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

Combination of exchange & non-exchange transactions



This situation arises where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received.

Combination of exchange & non-exchange transactions



Illustration

KNH receives USD 6 million funding from **UKaid** to equip its cancer unit. The agreement stipulates that KNH must repay USD 5 million of the funding received over a period of 10 years, at 5% interest when the market rate for a similar loan is 11%.

Required

Identify the exchange and non-exchange components of this transaction.

Combination of exchange & non-exchange transactions



Solution

KNH has effectively received a USD 1 million grant (USD 6 million received less USD 5 million to be repaid) and entered into USD 5 million concessionary loan which attracts interest at 6% below the market interest rate for a similar loan. The USD 1 million grant received, as well as the off-market portion of the interest payments in terms of the agreement, are **non-exchange transactions**. The contractual capital and interest payments over the period of the loan are **exchange transactions**.

Combination of exchange & non-exchange transactions



In determining whether a transaction has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.

A government levies taxation on individuals and other entities, known as taxpayers, within its jurisdiction by use of its sovereign powers.

Tax laws and regulations;

- (a) establish a government's right to collect the tax,
- (b) Identify the basis on which the tax is calculated, and
- (c) establish procedures to administer the tax, that is, procedures to calculate the tax receivable and ensure payment is received.

NB Tax laws and regulations often require taxpayers to file periodic returns to the government agency that administers a particular tax.

Measurement of non-exchange revenue & performance obligations



Revenue from non-exchange transactions shall be measured at the amount of the increase in net assets recognized by the entity.

A present **obligation** is a duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction.

A present obligation arising from a non-exchange transaction that meets the definition of a liability shall be recognized as a liability when, and only when:

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

Performance obligations cont'd



In the normal course of operations, a reporting entity may accept resources prior to a taxable event occurring. In such circumstances, a liability of an amount equal to the amount of the advance receipt is recognized until the taxable event occurs.

If a reporting entity receives resources prior to the existence of a binding transfer arrangement, it recognizes a liability for an advance receipt until such time as the arrangement becomes binding.

The amount recognized as a liability shall be the best estimate of the amount required to settle the present obligation at the reporting date.

Expenses paid through the tax system



A government may pay part of residents' health insurance premiums, to encourage the uptake of such insurance, either by reducing the individual's tax liability, making a payment by check, or by paying an amount directly to the insurance company. In these cases, the amount is payable irrespective of whether the individual pays taxes. Consequently, this amount is an expense of the government and should be recognized separately in the statement of financial performance.

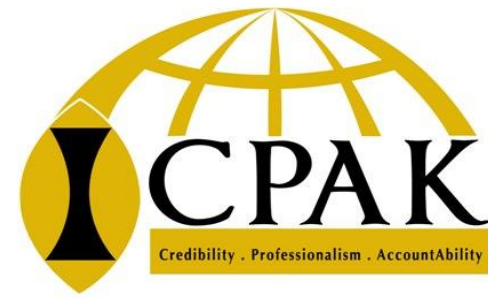
Tax revenue should be increased for the amount of any of these expenses paid through the tax system.

Tax expenditures



In most countries, governments use the tax system to encourage certain financial behavior and discourage other behavior. For example, in Kenya, homeowners are permitted to deduct mortgage interest from their gross income when calculating tax-assessable income. These types of concessions are available only to taxpayers. If an entity (including a natural person) does not pay tax, it cannot access the concession. These types of concessions are called **tax expenditures**.

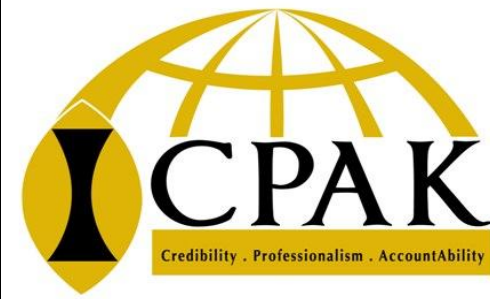
Transfers



Transfers include grants, debt forgiveness, fines, bequests, gifts, donations, and goods and services in-kind. All these items have the common attribute that they transfer resources from one entity to another without providing approximately equal value in exchange

Transfers satisfy the definition of non-exchange transactions because the transferor provides resources to the recipient entity without the recipient entity providing approximately equal value directly in exchange.

Debt forgiveness & assumption of liabilities



Lenders will sometimes waive their right to collect a debt owed by a public sector entity, effectively cancelling the debt. For example, a national government may cancel a loan owed by a state corporation. In such circumstances, the state corporation recognizes an increase in net assets because a liability it previously recognized is extinguished.

Revenue arising from debt forgiveness is measured at the carrying amount of the debt forgiven.

Fines



Fines are economic benefits or service potential received or receivable by a public sector entity, from an individual or other entity, as determined by a court or other law enforcement body, as a consequence of the individual or other entity breaching the requirements of laws or regulations.

Fines normally require an entity to transfer a fixed amount of cash to the government, and do not impose on the government any obligations which may be recognized as a liability.

Bequests



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 resources embodying future economic benefits or service potential for a bequest occurs when the entity has an enforceable claim, for example on the death of the testator, or the granting of probate, depending on the laws of the jurisdiction.

Gifts & Donations, including goods in-kind

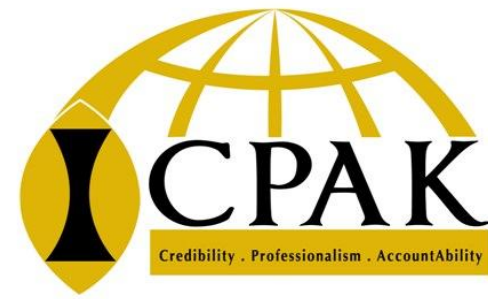


Gifts and donations are voluntary transfers of assets, including cash or other monetary assets, goods in-kind, and services in-kind that one entity makes to another, normally free from stipulations.

Goods in-kind are tangible assets transferred to an entity in a non-exchange transaction, without charge, but may be subject to stipulations. External assistance provided by multilateral or bilateral development organizations often includes a component of goods in-kind.

Gifts and donations (other than services in-kind) are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably.

Gifts & Donations, including goods in-kind



Goods in-kind are recognized as assets when the goods are received, or there is a binding arrangement to receive the goods. If goods in-kind are received without conditions attached, revenue is recognized immediately. If conditions are attached, a liability is recognized, which is reduced and revenue recognized as the conditions are satisfied.

Services in-kind



Services in-kind are services provided by individuals to public sector entities in a non-exchange transaction for example:

- (a) Technical assistance from other governments or international organizations;
- (b) Persons convicted of offenses may be required to perform community service for a public sector entity;
- (c) Public hospitals may receive the services of volunteers;
- (d) Public schools may receive voluntary services from parents as teachers' aides or as board members; and
- (e) A county governments may receive the services of volunteer fire fighters/ambulances (*Sonko rescue team?*)

Services in-kind



Due to the many uncertainties surrounding services in-kind, including the ability to exercise control over the services, and measuring the fair value of the services, IPSAS 23 does not require the recognition of services in-kind.

Disclosure of the nature and type of services in-kind received during the reporting period (if they are material) is however encouraged.

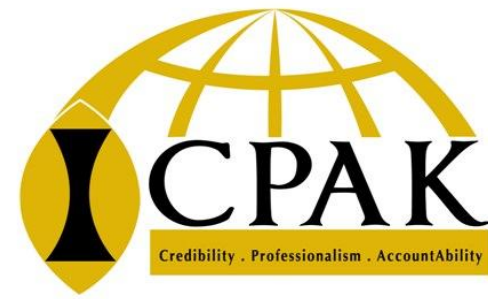
Pledges



Pledges are unenforceable undertakings to transfer assets to the recipient entity. Pledges do not meet the definition of an asset, because the recipient entity is unable to control the access of the transferor to the future economic benefits or service potential embodied in the item pledged.

Entities do not recognize pledged items as assets or revenue. If the pledged item is subsequently transferred to the recipient entity, it is recognized as a gift or donation. Pledges may warrant disclosure as **contingent assets** under the requirements of IPSAS 19.

Advance receipts of transfers



Where an entity receives resources before a transfer arrangement becomes binding, the resources are recognized as an asset when they meet the definition of an asset and satisfy the criteria for recognition as an asset. The entity will also recognize an advance receipt liability if the transfer arrangement is not yet binding.

A liability is recognized until the event that makes the transfer arrangement binding occurs, and all other conditions under the agreement are fulfilled.

Concessionary Loans



Concessionary loans are loans received by an entity at below market terms.

Where an entity determines that the difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition is non-exchange revenue, an entity recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred assets by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.

Key Disclosures



An entity shall disclose either on the face of, or in the notes to, the general purpose financial statements:

- a) The amount of revenue from non-exchange transactions recognized during the period by major classes showing separately:
 - (i) Taxes, showing separately major classes of taxes; and
 - (ii) Transfers, showing separately major classes of transfer revenue.
- (b) The amount of receivables recognized in respect of non-exchange revenue;
- (c) The amount of liabilities recognized in respect of transferred assets subject to conditions;
- (cA) The amount of liabilities recognized in respect of concessionary loans that are subject to conditions on transferred assets;
- (d) The amount of assets recognized that are subject to restrictions and the nature of those restrictions;
- (e) The existence and amounts of any advance receipts in respect of non-exchange transactions; and
- (f) The amount of any liabilities forgiven.

Key Disclosures cont'd



An entity shall disclose in the notes to the general purpose financial statements:

- (a) The accounting policies adopted for the recognition of revenue from non-exchange transactions;
- (b) For major classes of revenue from non-exchange transactions, the basis on which the fair value of inflowing resources was measured;
- (c) For major classes of taxation revenue that the entity cannot measure reliably during the period in which the taxable event occurs, information about the nature of the tax; and
- (d) The nature and type of major classes of bequests, gifts, and donations, showing separately major classes of goods in-kind received.

Thank You!



Questions?

