IPSAS 23:
Revenue from Non-Exchange Transactions
(Taxes and Transfers)

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General overview

- Introduction and definition of terms
- Nature of non-exchange transactions and scope of the standard
- Taxes and transfers
- General principles on recognition and measurement non-exchange revenue
- Practical examples on how to account for non-exchange revenue
- Key disclosure requirements
- Practical Implementation challenges

Introduction

- Issued on Dec 2006
- Effective application FY beginning on or after June 2008
- IPSAS 23 has no equivalent counterpart under IAS/IFRS
- Prescribes requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination.

Definition

- Non-exchange transactions - are transactions that are not exchange transactions.

Provide some consideration directly in return for the resources received

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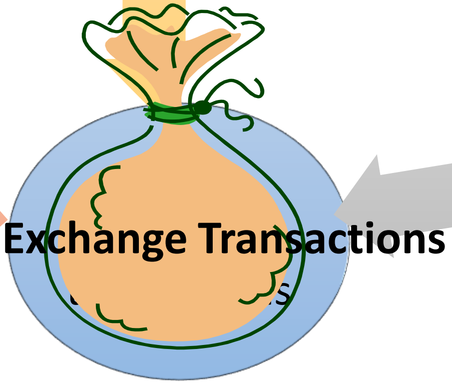
Fair value of the resources received

Separate Exchange & non exchange part

Receive resources and provide no or nominal consideration directly in return



Transactions not immediately clear whether they are exchange or non-exchange transactions

Substance of transaction

Revenues

- Revenue includes only the ***gross inflows*** of ***economic benefits*** or ***service potential received*** and ***receivable*** by the entity on its ***own account*** which represents an increase in net assets/equity, other than increases relating to contributions from owners.

- An entity recognize an asset when the transferred resources meet the **definition of an asset** and satisfy the criteria for **recognition as an asset**.

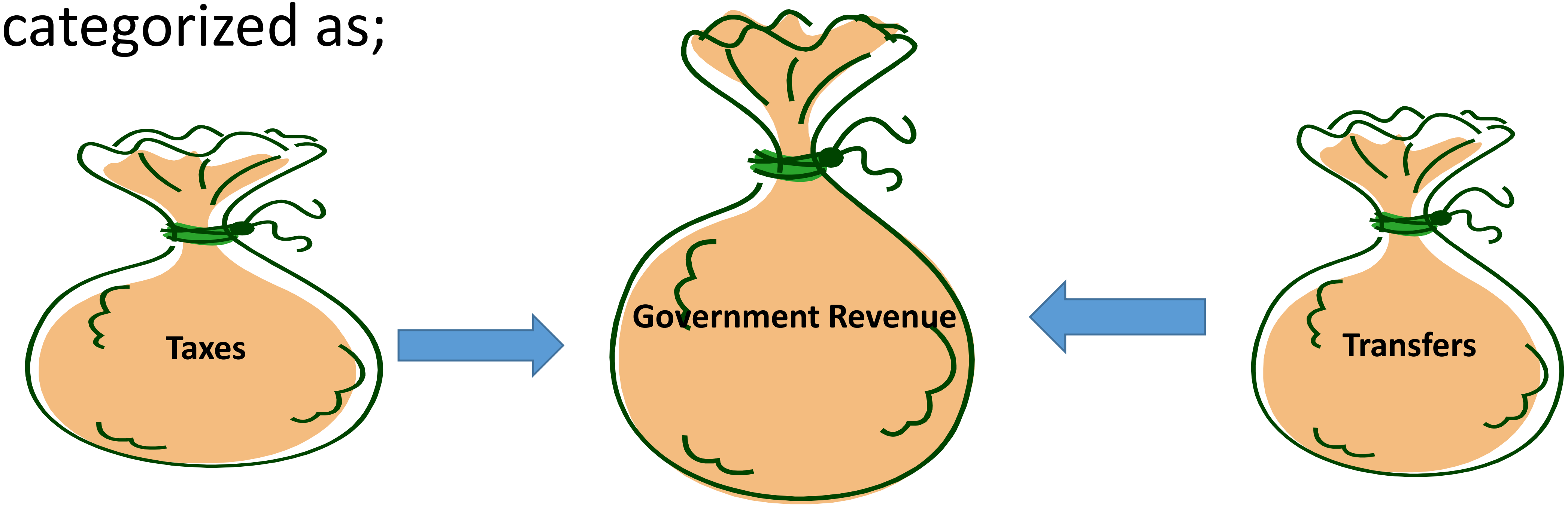
- An inflow shall be recognized as an asset when, and only when:

a) it is probable that the future economic benefits or service potential associated with the asset will flow to the entity

b) The fair value of the asset can be measured reliably.

Revenues….contd

- Majority of revenues received by government and public sector entities (PSE) arise from non-exchange transactions categorized as;



Taxes

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

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

- **Taxable event**: the event that the government legislature, or other authority has determined will be subject to taxation.

- Examples of taxes.

Taxes related terms

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

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

Transfers

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

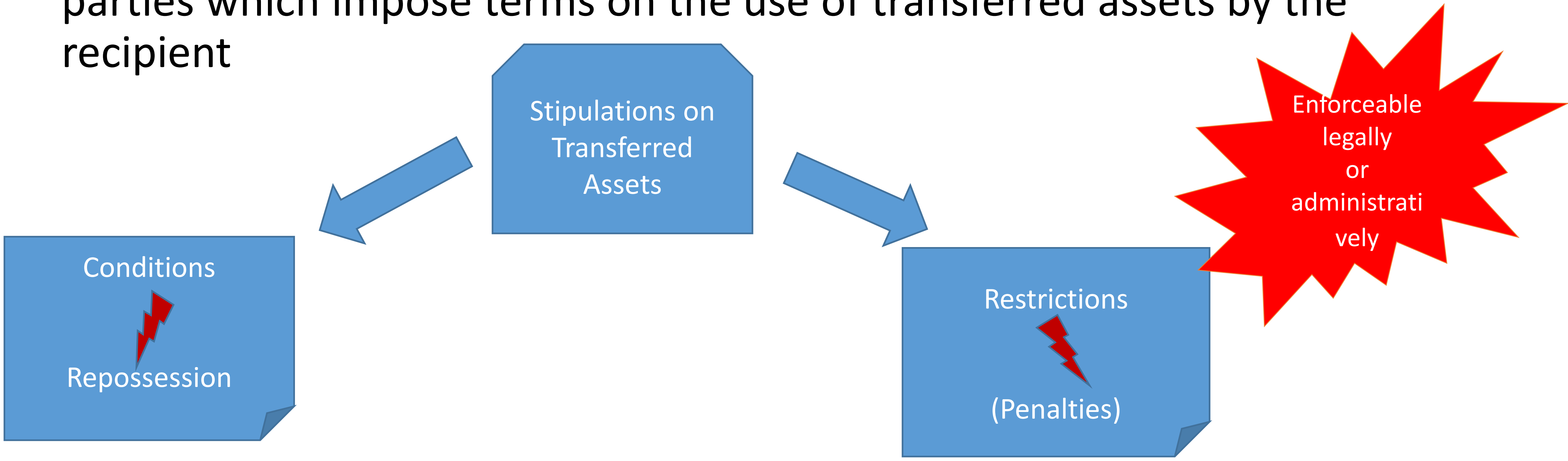
- Transfers provides resources to the recipient entity without the recipient entity providing approximately equal value directly in exchange.

- Transfers (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.

Transferred assets

Stipulations on transferred Assets.

These are laws, regulations, or binding arrangements with external parties which impose terms on the use of transferred assets by the recipient



Transferred Assets.....contd

Conditions on Transferred Assets

- Conditions on transferred assets require that the entity either consume the future economic benefits or service potential of the asset as specified, or **return future** economic benefits or service potential to the transferor in the event that the **conditions are breached.**
- The recipient incurs a present obligation to transfer future economic benefits or service potential to third parties when it initially gains control of an asset subject to a condition.
- When a recipient initially recognizes an asset that is subject to a condition, the recipient also incurs a liability (deferred revenue).

Examples: Delivery of good /services to third parties, construction of XX houses for the poor in a slum upgrade program or return of funds

Transferred assets….contd

Restrictions on Transferred Assets

- The transferred asset, or other future economic benefits or service potential, is **NOT** to be returned to the transferor if the asset is not deployed as specified or obligation fulfilled.

- Rather penalties are imposed through a court or other tribunal, or an administrative process such as a directive from a government minister or other authority.

- Such actions may result in fulfillment of the restriction or a civil or criminal penalty for defying the authority.

- The penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.
- Recognized as a revenue initially.

Examples:

Transfer of land to a university to build a campus and not conditions on return mentioned

Recognition of Revenue from NETs…contd

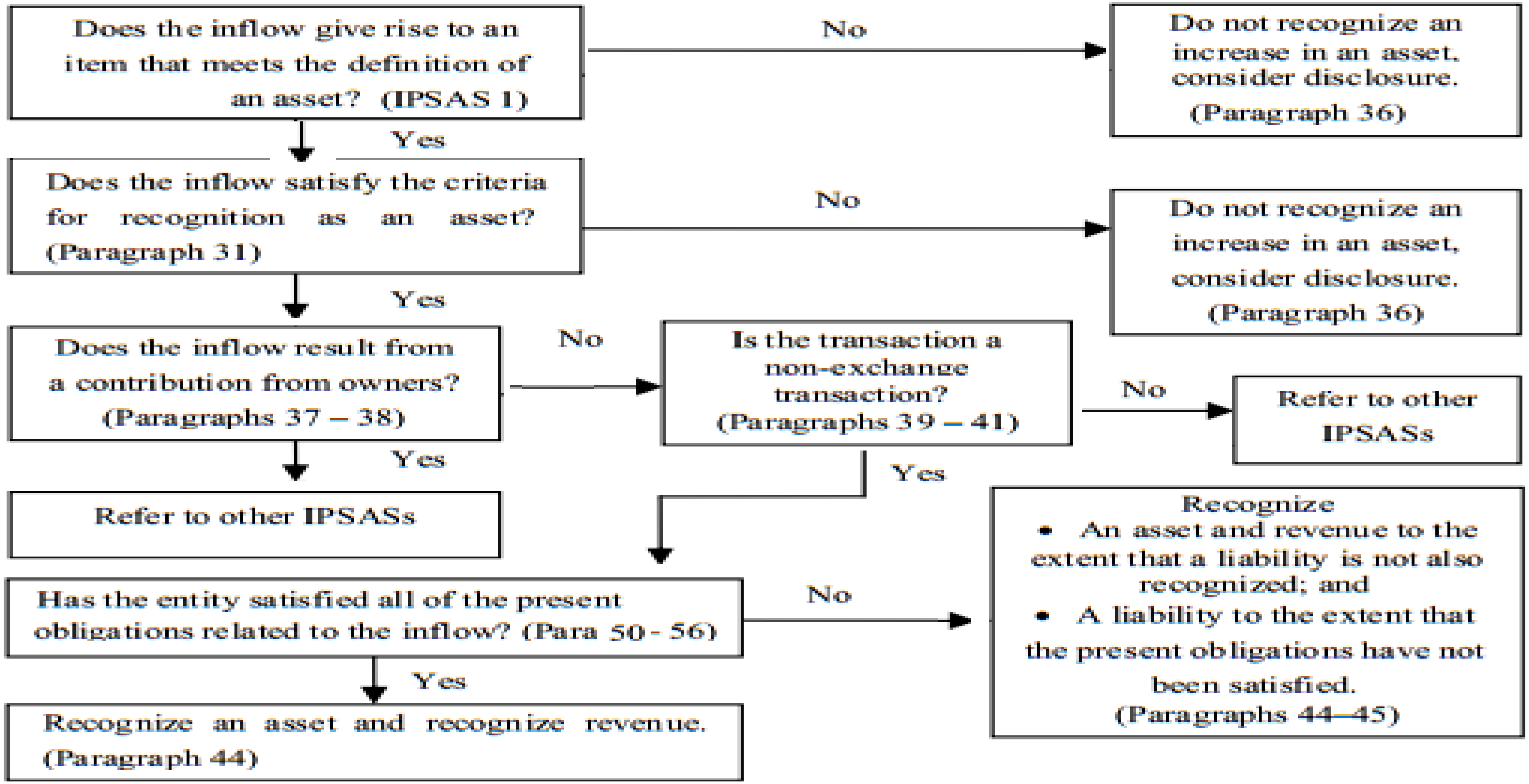
- An entity will recognize an asset arising from a NET when it gains control of resources that meet the definition of an asset and satisfy the recognition criteria.
- The timing of revenue recognition is determined by the nature of the conditions and their settlement.
- For example, if a condition specifies that the entity is to provide goods or services to third parties, or return unused funds to the transferor, revenue is recognized as goods or services are provided.

Recognition of Revenue from Non-Exchange Transactions

- The initial inflow of the resource needs to be assessed in order to determine:
  - ❖ If the transaction is a non-exchange revenue transaction
  - ❖ whether an asset and related revenue can be recognized
  - ❖ or if an asset and a liability (deferred revenue) must be recognized.

- Examples: Tax assets are recognized when the taxable event occurs and the asset recognition criteria are met

Initial Analysis of Inflow



Measurement of from Non-exchange Transactions

- Analyze non-exchange transactions to determine which elements of GPFS will be recognized as a result of the transactions.
    - ❖ Revenue from non-exchange transactions is measured at the amount of the increase in net assets recognized by the entity.
    - ❖ Assets acquired through non-exchange transactions are initially measured at fair value as at the date of acquisition.
    - ❖ The amount recognized as a liability must be the best estimate of the amount required to settle the present obligation at the reporting date.

Measurement of Revenue from NETs…contd

- Non-exchange transaction, may require an entity recognizes an asset and revenue or an asset and a liability (deferred revenue).

- When a liability is subsequently reduced, because the taxable event occurs, or a condition is satisfied, the amount of the reduction in the liability will be recognized as revenue.

Entities should develop accounting policies for the recognition and measurement of assets that are consistent with IPSASs (12, 16 and 17).

Examples

Debt Forgiveness and Assumption of Liabilities

- This is a waiver of right to collect a debt owed by a public sector entity, effectively canceling the debt by the lender.
- For example, a national government may cancel a loan owed by a local government. In such circumstances, the local government recognizes an increase in net assets because a liability it previously recognized is extinguished.
- Entities recognize revenue in respect of debt forgiveness when the former debt no longer meets the definition of a liability or satisfies the criteria for recognition as a liability, provided that the debt forgiveness does not satisfy the definition of a contribution from owners.
- Where a controlling entity forgives debt owed by a wholly owned controlled entity, or assumes its liabilities, the transaction may be a contribution from owners.
- Revenue arising from debt forgiveness is measured at the carrying amount of the debt forgiven.

Advance Receipts of Taxes

- Resources for taxes received prior to the occurrence of the taxable event are recognized as an asset and a liability (advance receipts), because:

    - ❖ the ***event*** that gives rise to the entity’s entitlement to the taxes ***has not occurred***, and
    - ❖ the ***criteria for recognition*** of taxation revenue have not been satisfied.

- When the taxable event occurs, the liability is discharged and revenue is recognized.

Fines

- Fines are economic benefits or service potential received or receivable by a PSE, 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.
- Where a defendant reaches an agreement with a prosecutor that includes the payment of a penalty instead of being tried in court, the payment is recognized as a fine.
- 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.
- As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset.
- Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.

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.
- Bequests that satisfy the definition of an asset 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.
- Bequests are measured at the fair value of the resources received or receivable.

Gifts and 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.
- For gifts and donations of cash or other monetary assets and goods in-kind, the past event giving rise to the control of resources embodying future economic benefits or service potential is normally the receipt of the gift or donation.
- 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.
- Measured at their fair value as at the date of acquisition

Transfer of assets

- A State Agency (reporting entity) purchases land with a fair value of KES 500,000 for KES 150,000 from a donor.

- The reporting entity concludes that the non-exchange transaction comprises two components, an exchange component and a non-exchange component. One component involves the purchase of a share in the land for KES 150,000, the other component is a non-exchange transaction that transfers the remaining share of the land to the school.

- In its GPFS for the reporting period in which the transaction takes place, the State Agency recognizes the land at KES 500,000, (a cost of KES 150,000 and a transfer of KES 350,000) a reduction in its asset "cash" of KES 150,000 and revenue from a non-exchange transaction of KES 350,000 (the fair value of the increase in net assets recognized).

Services In-kind

- Services in-kind are services provided by individuals to PSE in a NET and meet the definition of an asset because the entity controls a resource from which future economic benefits or service potential are expected to flow to the entity.
- These assets are, however, immediately consumed, and a transaction of equal value is also recognized to reflect the consumption of these services in-kind.
- In developing an accounting policy addressing a class of services in-kind, various factors would be considered, including the effects of those services in- kind on the financial position, performance, and cash flows of the entity.
- The extent to which an entity is dependent on a class of services in-kind to meet its objectives, may influence the accounting policy an entity develops regarding the recognition of assets.
- For example, an entity that is dependent on a class of services in-kind to meet its objectives, may be more likely to recognize those services in-kind that meet the definition of an asset and satisfy the criteria for recognition.

Services In-kind…..contd

- In determining whether to recognize a class of services in-kind, the practices of similar entities operating in a similar environment are also considered.
- Examples of services in-kind under voluntary or non-voluntary schemes operated in the public interest:
  - ❖ Governments /international organizations technical assistance
  - ❖ Community service for a public sector entity from offenders
  - ❖ Services of volunteers in public hospitals
  - ❖ Voluntary services from parents as teachers' aides or as board members for public schools
  - ❖ volunteer fire fighters services for local governments
- An entity may, but is not required to, recognize services in-kind as revenue and as an asset. Due to materiality, measurement and control limitations

Summary on recognition and measurement

This assets-liabilities approach with respect to recognition of revenues, works as follows:

1. Determine if the entity can recognize an asset from a non-exchange transaction.
2. Identify the stipulations attached to the transaction or arrangement and determine if they give rise to conditions or restrictions.
3. Recognize revenue to the extent that an asset is recognized, and any present obligation is satisfied (i.e. to the extent that conditions are met).
4. Measure revenue at the amount of the increase in net assets recognized by the entity.

Disclosures

An entity shall disclose either on the face of, or in the notes to, the GPFS;

a) The amount of revenue from NET recognized during the period by major classes showing separately:

- Taxes, showing separately major classes of taxes; and
- 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;

- 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 NETs and

f) The amount of any liabilities forgiven.

Disclosures

- An entity shall disclose in the notes to the GPFS
  - ❖ The accounting policies adopted for the recognition of revenue from NETs ;
  - ❖ For major classes of revenue from NETS , the basis on which the fair value of inflowing resources was measured;
  - ❖ 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
  - ❖ The nature and type of major classes of bequests, gifts, and donations, showing separately major classes of goods in-kind received.


Thank you


Q&A