FINANCIAL REPORTING FOR COUNTY GOVERNMENTS

REVENUE FROM EXCHANGE TRANSACTIONS (IPSAS 9)
REVENUE FROM NON-EXCHANGE TRANSACTION
REVENUE FROM NON-EXCHANGE TRANSACTION TAXES & TRANSFERS (IPSAS 23)

Presentation by:
CPA P/FA SOLOMON NGAHU
HEAD OF FINANCIAL REPORTING – ROR & ADMIN SERVICES

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Uphold public interest

PRESENTATION OUTLINE

1. General overview of IPSAS 9
2. Non-exchange transactions and their Sources
3. General principles on Measurement ETs
4. Revenue Recognition and Disclosures IPSAS-9
5. Application , Practical examples & Challenges.
6. Overview ,Scope and Definitions of IPSAS 23
7. Transaction Identification
8. Revenues and Definitions
9. Conditions on Transferred Assets
10. Recognition of revenues from NET
11. Measurement of Transferred Asset
12. Disclosures IPSAS-23

IPSAS 9

General overview and Scope

- Comparative of IPSAS 9 is IAS 18 on Revenue
- Entities reporting accrual basis of accounting should apply this standard
- The Standard applies to all public sector entities except Government Busines Enterprises (GBEs)
- This standard considers revenues arising from the following sources;
  - ✓ Rendering of the services
  - ✓ The Sale of goods; and
  - ✓ Use by other entities yielding ; Dividends, Royalties and Interests
- *This standard does not deal with revenues arising from non exchange transactions*

EXCHANGE TRANSACTIONS

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 .

Examples of exchange transactions includes;

a) Purchase or sale of goods and services; or
b) The lease of property, plant and equipment's at market prices

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, trading license, fees, passport application-fees, electricity/water/telephone bills payment, etc by the ***HUDUMA CENTRE and E-Citizen through Digital Payment*** 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 NTSA 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.

Cont`

- 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

- For 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.

GOODS AS PER IPSAS 9

Definition of Goods as per IPSAS 9 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.

Cont`

- **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.
- When goods or services are swapped for similar goods and services of similar value and nature this exchange is not regarded as exchange that generate revenue.
- 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.

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- 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.
- The difference between the fair value and nominal value is recognized as interest revenue

RENDERING OF SERVICES

- Estimation of transactions rendering the services can be estimated reliably. Reference of such transaction should be recognized based on the stage of completion of the transaction as the reporting date;
- The following conditions are necessary for reliable estimation of the transactions;
  - ✓ *The amount of revenue can be measured reliably;*
  - ✓ *Economic benefits will flow as revenue to the entity;*
  - ✓ *The stage of completion of the transaction at the reporting date ; and*
  - ✓ *Cost incurred for the transaction and completion cost can be estimated reliably.*

STAGE OF COMPLETION

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

- ✓Surveys of work performed;
- ✓ Services performed to date as a percentage of total services to be performed; or
- ✓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:

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

REVENUE RECOGNISION

Revenue shall be recognized using the following accounting

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

KEY 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:

- ✓The rendering of services;
- ✓The sale of goods;
- ✓Interest;
- ✓Royalties; and
- ✓Dividends or similar distributions; and

(c) The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

APPLICATION IN KENYA

- ***Section 82, 89 & 165 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.*
- *Section 192 establish PSASB to guide on reporting frameworks*

CHALLENGES

- ✓ An accrual standard but some entities (e.g MDAs, County Government) are currently preparing reports on cash basis (receivers of revenues reports)
- ✓ Data mismatch especially where entities like postal corporation (Huduma Centre & E-citizens) collect revenues as agents for others.
- ✓ Re-structuring especially within various public entities especially where entities are merged with others or completely scrapped off.

IPSAS - 23

SCOPE

- ✓This Standard was 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.

GENERAL OVERVIEW

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 non-cash), including grants, debt forgiveness, fines, bequests, gifts, donations, goods and services in kind, and the off-market portion of concessionary loans received.

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

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.
- 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.

ILLUSTRATION

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.

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**.

Transaction Identification

- 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.

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.

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

- Taxes
- Government-Revenues
- Transfers

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 ;

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

Taxes Expenditure

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

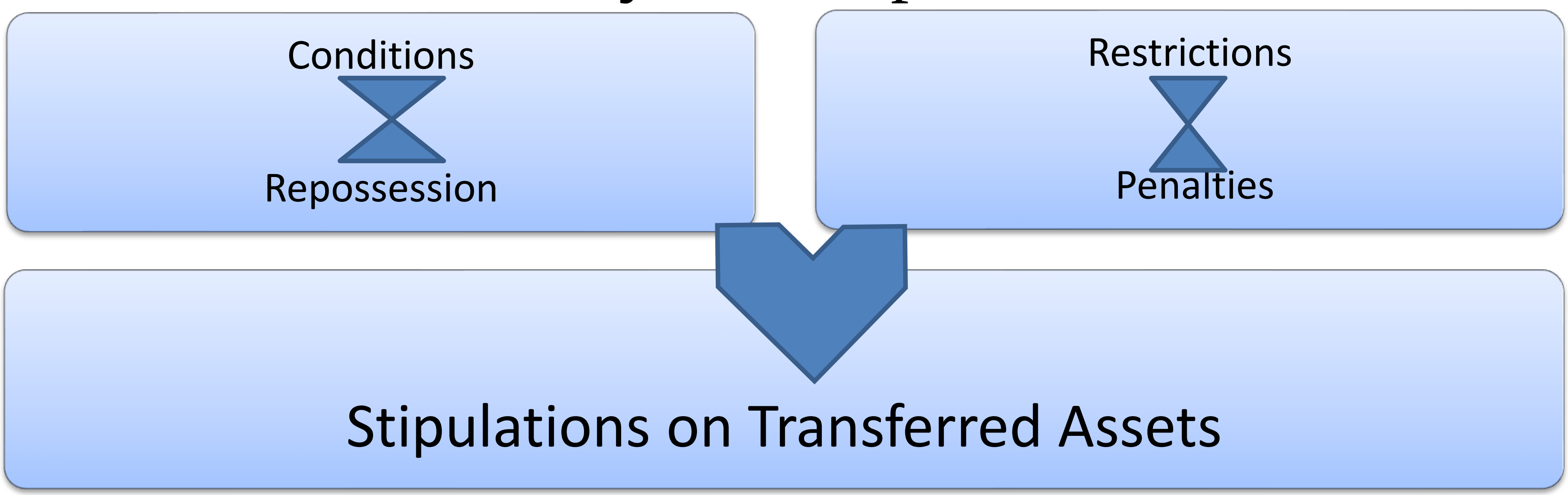
- Transfers provides resources to the recipient entity without the recipient entity providing approximately equal value directly in exchange.

- Transfers (cash or non-cash), 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 ie ;



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

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 Non-Exchange Transactions

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.

- ✓ 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*

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.

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- 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).

Debt forgiveness & 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.

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 & 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.
- ✓ Gifts & Donations measured at their fair value as at the date of acquisition.
- ✓ A State Agency (reporting entity) purchases land with a fair value of KES 500,000 for KES 150,000 from a donor.

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

SERVICES IN-KIND

- Services in-kind are services provided by individuals to public sector entities in a non-exchange transaction for example:
- Technical assistance from other governments or international organizations;
- Persons convicted of offenses may be required to perform community service for a public sector entity;
- Public hospitals may receive the services of volunteers;
- Public schools may receive voluntary services from parents as teachers' aides or as board members; and
- A county governments may receive the services of volunteer fire fighters/ambulances ***(Sonko rescue team?)***
- *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*.

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- ✓ 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.
- ✓ 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;
  1) Governments /international organizations technical assistance
  2) Community service for a public sector entity from offenders
  3) Services of volunteers in public hospitals
- ✓ 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 Disclossures

- An entity shall disclose either on the face of, or in the notes to, the GPFS;
- 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.
- The amount of receivables recognized in respect of non-exchange revenue;
- The amount of liabilities recognized in respect of transferred assets subject to conditions;

Cont`

- The amount of liabilities recognized in respect of concessionary loans that are subject to conditions on transferred assets;
- The amount of assets recognized that are subject to restrictions and the nature of those restrictions;
- The existence and amounts of any advance receipts in respect of non-exchange transactions; and
- The amount of any liabilities forgiven.

OTHER DISCLOSURES

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

- ✓The accounting policies adopted for the recognition of revenue from non-exchange transactions;
- ✓For major classes of revenue from non-exchange transactions, 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.

DISCUSSIONS

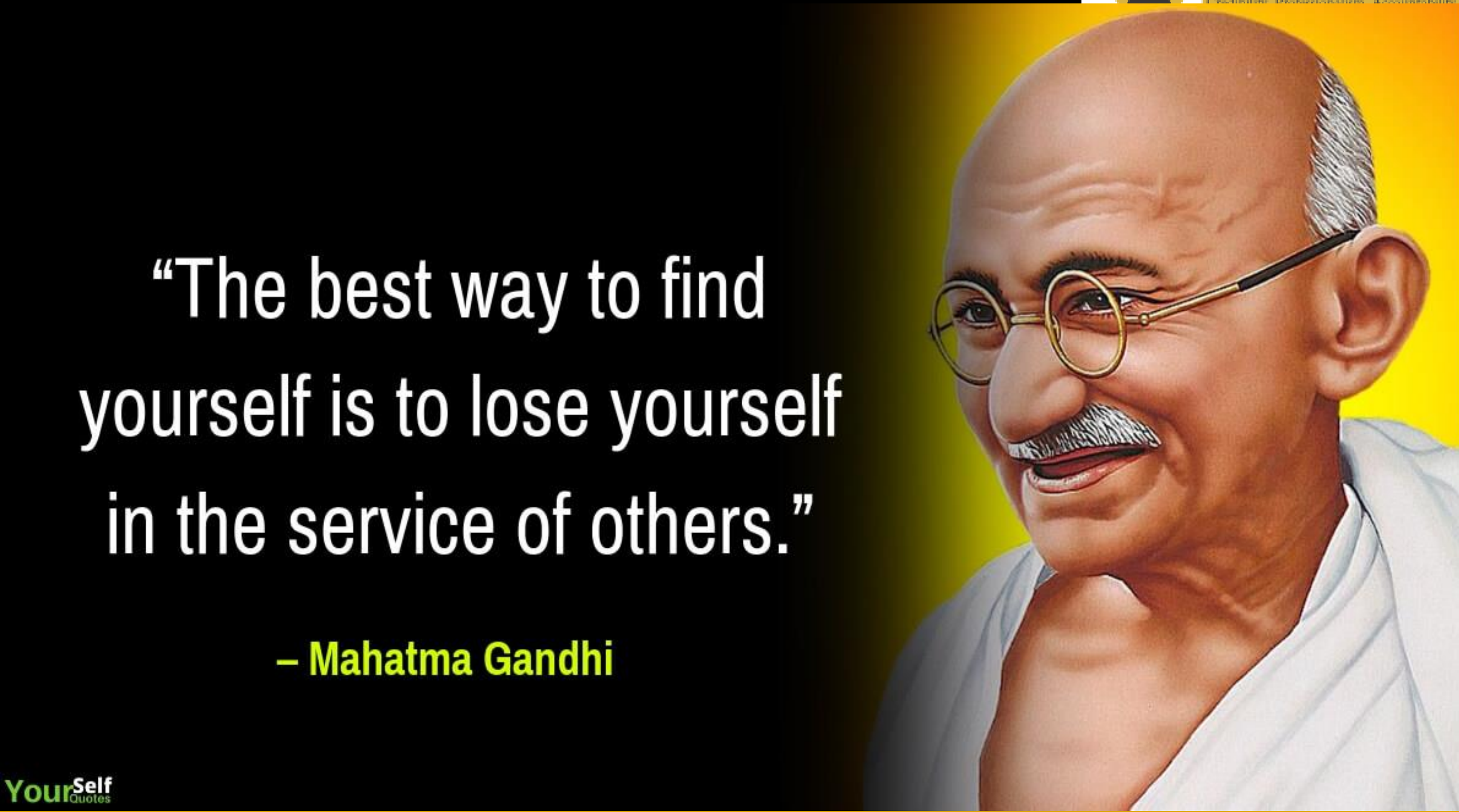
Q & A

QUOTES OF THE DAY

Credibility . Professionalism . Accountability

INTEGRITY IS
choosing
COURAGE OVER COMFORT;
CHOOSING WHAT IS RIGHT
over what is
FUN, FAST, OR EASY;
AND CHOOSING TO
PRACTICE OUR VALUES
rather than simply
PROFESSING THEM.

FINALY;


"The best way to find yourself is to lose yourself in the service of others."
– Mahatma Gandhi
YourSelf Quotes

CONTACTS

CPA PFA SOLOMON NGAHU
Head of Financial Reporting Unit, The National Treasury
+254723508542 /+254722834192
Solomon.ngahu3@gmail.com /
solomon.ngahu@treasury.go.ke