Introduction to International Public Sector Accounting Standards (IPSAS) Workshop Transcript Session 4: Revenues

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We will now begin session 4 of the workshop, Revenues.

This session will include a brief introduction on revenues and then discuss two revenue standards, IPSAS 9 which provides guidance on the accounting for revenue from exchange transactions and IPSAS 23 which provides guidance on the accounting for revenue from non-exchange transactions.

It is important to mention that at this time that the IPSASB has an active project reviewing the accounting for certain non-exchange transactions in IPSAS 23. Specifically, the IPSASB is reviewing the accounting for transfers. As a result of this active project, we will not explore all aspects of IPSAS 23, as they are subject to change. However, we will explore the accounting for taxes as it is our understanding that this, most likely, will not change.

So I will now pass it to Iman to walk us through Revenue.

Iman Sheikh: Let's go back to the basics and take a look at the definition of revenue:

Revenue is the gross inflow of economic benefits or service potential resulting in increases in net assets/equity.

Revenue excludes increases in net assets/equity relating to contributions from owners.

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 are not economic benefits or service potential that flow to the entity, and do not result in increases in assets or decreases in liabilities. This is because the agent entity cannot control the use of, or otherwise benefit from, the collected assets in the pursuit of its objectives. Therefore, they are excluded from revenue.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

When collection Is not probable, expense is recognized.

Public sector entities may derive revenues from exchange or non-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.

Applies to:

a) rendering of services;
b) sale of goods including the sale of land and other property held for resale; and
c) use by others of entity assets yielding interest, royalties, and dividends or similar distributions.

Exchange transactions should be accounted for under IPSAS 9, Revenue from Exchange Transactions and we will take a look at it in our next slides.

Non-exchange transactions are transactions that 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.

Examples of non-exchange transactions are:

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.

Non-exchange transactions should be accounted for under IPSAS 23, Revenue from Non-exchange Transactions (Taxes and Transfers).

So let’s take a look at IPSA 9 first, revenue from exchange transactions.

Revenue is recognized under IPSAS 9 from the following transactions:

- Rendering of services on percentage completion method
- Sale of goods when significant risks and rewards of ownership and effective control transferred
- Interest on time proportion basis using effective yield
- Royalties as earned
- Dividends when right to receive payment established

We will be discussing each one of these transactions as part of this presentation.

Revenue 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. In most cases, the consideration is in the form of cash or cash equivalents, and the amount of revenue is the amount of cash or cash equivalents received or receivable.

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The recognition criteri in IPSaS 9 are usually applied to each transaction in order to reflect the substance of each transaction.

When a transaction involves the rendering of services, revenue associated with the transaction is recognized by reference to the stage of completion of the transaction at the reporting date.

Antonella Risi: What do you mean by “stage of completion”?

Iman Sheikh: This is called the percentage completion method. Under this method, revenue is recognized in the reporting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period.

Under the percentage completion method, revenue is recognized when the outcome of a transaction can be estimated reliably.

The outcome of a transaction can be estimated reliably when:

a) The amount of revenue can be measured reliably;
b) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity;
c) The stage of completion of the transaction at the reporting date can be measured reliably; and
d) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

On the next slide we have some examples of rendering services. Let’s take a look at them.

Housing: Rental income from the provision of housing is recognized as the income is earned in accordance with the terms of the tenancy agreement.

School Transport: Revenue from fares charged to passengers for the provision of school transport is recognized as the transport is provided.

Management of Toll Roads: Revenue from the management of toll roads is recognized as it is earned, based on the usage of the roads.

Financial Service Fees: The recognition of revenue for financial service fees depends on (a) the purposes for which the fees are assessed, and (b) the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective yield of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

Admission Fees: Revenue from artistic performances, banquets, and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.
Tuition Fees: Revenue is recognized over the period of instruction.
Franchise or Concession Fees: Franchise or concession fees may cover the supply of initial and subsequent services, equipment and other tangible assets. Accordingly, franchise or concession fees are recognized as revenue on a basis that reflects the purpose for which the fees were charged.

When a transaction involves the sale of goods, the assessment of when an entity has transferred the significant risks and rewards of ownership to the purchaser requires an examination of the circumstances of the transaction.

That's because in most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the purchaser. This is the case for most sales.

Preparers know if the significant risks and rewards were transferred.

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Here we have other exchange revenues:

Interest is recognized on a time proportion basis that takes into account the effective yield on the asset. Royalties are recognized as they are earned in accordance with the substance of the relevant agreement.

Dividends or their equivalents are recognized when the shareholder's or the entity's right to receive payment is established.

The general recognition criteria apply. Revenue would be recognized when it is probable that the economic benefit or service potential associated with the transaction will flow to the entity and the amount can be measured reliably.

Now let's turn our attention to IPSAS 23, specifically the accounting for taxes.

An entity that imposes taxes recognizes an asset in respect of taxes when the taxable event occurs, and the asset recognition criteria are met.

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

The fair value of assets arising from taxation transactions are measured at the best estimate of the inflow of resources to the entity. The best estimate will take account of both the probability that the resources will flow to the government, and the fair value of the resultant assets.

When assets and revenue arising from taxation transactions are measured using statistical models, the actual amount realized in subsequent reporting periods may be different from the estimated amounts determined as being due from taxpayers in respect of the current reporting period. Revisions to estimates are made prospectively in accordance with IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors.

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

i. the event that gives rise to the entity's entitlement to the taxes has not occurred, and
ii. the criteria for recognition of taxation revenue have not been satisfied.

Taxation revenue shall be determined at a gross amount. It shall not be reduced for expenses paid through the tax system and not grossed up for tax expenditures.

Antonella Risi: What are the expenses paid through the tax system and tax expenditures?

Iman Sheikh: 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. These affect the amount of tax revenue to which an entity is entitled.

Some taxes are levied for specific purposes. Generally, taxes levied for a specific purpose do not create a performance obligation that requires a liability to be recognized because the specific purposes amount to restrictions on how the resources are used. The entity retains discretion in how it uses the resources. If the resources are not used for the intended purpose, there is no obligation to return the resources.

An entity discloses 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. each major class of taxes; and
    ii. each major class of transfer revenue.
b) The amount of receivables recognized in respect of non-exchange revenue;
c) The existence and amounts of any advance receipts in respect of non-exchange transactions; and
d) The amount of any liabilities forgiven.

An entity also discloses 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.

In many cases an entity will be able to reliably measure assets and revenue arising from taxation transactions, using, for example, statistical models. However, there may be exceptional circumstances where an entity is unable to reliably measure the assets and revenue arising until one or more reporting periods has elapsed since the taxable event occurred. In these cases, the entity makes disclosures about the nature of major classes of taxation that cannot be reliably measured, and therefore recognized, during the reporting period in which the taxable event occurs. These disclosures assist users to make informed judgments about the entity’s future revenue and net asset position

This is the end of this session.

Antonella Risi: Thank you Iman for taking us through these revenue standards.