International Financial Reporting for Non Profit Organizations

Technical Advisory Group

AGENDA ITEM: TAGCP06-01
March 5, 2020 – Virtual Meeting

Recognition and measurement of incoming resources from external sources

Summary	The accounting treatment for certain types of incoming sources has been identified as a specific issue for the not-for-profit sector. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
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Actions for this meeting	Advise on: • The description of the issue and its relationship with other topics • Links to other international standard developments, national standards or other guidance • The need for any further input

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Recognition and measurement of incoming resources from external sources

Part 1 – Advice Sought

1. **Consultation Paper Draft**

1.1 At the TAG meeting on November 4, the TAG agreed that the recognition and measurement of incoming resources from external sources should be included in the short list of issues to be included in the Consultation Paper to provide a set of principles to consider the range of income received by NPOs.

1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to comments.

Question 1: What comments does the TAG have on Sections 1 and 2?

Question 2: Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance that should be included in the Consultation Paper?

1.3 A number of specific issues topics include 'do nothing' options, i.e. to continue to follow international standards with no additional guidance. In making the case for Guidance for the sector, in Part 1 of the CP, this effectively addresses the 'do nothing' option. This raises a question as to whether a 'do nothing' option should be included as a standard in all specific issue papers. Secretariat proposes that a 'do nothing' option is only included by exception.

Question 3: Does the TAG agree with the presentation of the key issues in section 5, which link to other topics for inclusion in the Consultation Paper?

Question 4: What comments does the TAG have on the proposed SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. **Next steps**

2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The PAG will be consulted on any specific issues raised by the TAG further to this discussion.

Question 5: Is there specific input to be sought from the PAG?

Part 2 - Draft Consultation Paper Text

Recognition and measurement of incoming resources from external sources

1. Description of the issue

1.1 NPOs receive incoming resources from a variety of external sources. They currently rely on funding through grants, cash donations for ongoing operating activities, cash donations for capital purposes, donations of assets or inventory (gifts in-kind), services in-kind and bequests and endowments. These forms of incoming resources are received without the contributor receiving something of equal value for their direct benefit in return (non-exchange transaction).

1.2 Incoming resources can also take the form of revenue earned from the sale of goods (e.g. sale of donated goods) and services (e.g. health services, tuition fees and membership services), research and from the use of the entity's assets (e.g. interest, royalties and dividends). In these cases the revenue received is more likely to approximate to the value to the goods and services directly received in return (exchange transactions).

1.3 In some transactions the amount of revenue received may be less than the approximate value of the goods and services received, with the revenue received comprising both an exchange and non-exchange component. For example, for membership organisations the membership fee may go in part to the direct benefits for the member (exchange) and in part might serve as a donation, contributing to the organisation's overall expenses (non-exchange). NPOs may face difficulties or additional costs in attributing incoming resources between these types of transactions.

1.4 An NPO can be in receipt of some or all of these incoming resources, and they in turn may or may not have performance obligations (conditions) or restrictions (either temporary or permanent), which result in it either using the revenue as required or returning it. This means not being entitled to the incoming resources until the NPO has performed certain activities or limiting how the incoming resources can be applied i.e. they can only be applied to specific purposes. This can create complexity for NPOs, knowing how and when these incoming resources should be reflected in their accounts.

1.5 For example, incoming resources from grants may be repayable if the related activity is not carried out or a grant may only be receivable if there are valid expenses which satisfy the accounting and reporting requirements of that donor. Lack of evidence of adherence to own procedures may lead to a disallowance of expenditure and a request for a refund.

1.6 There may be a number of different stages, which incoming resources need to reach on the way to being capable of recognition. Revenue can be; a contracted amount (as part of a multi-year agreement); committed amount (secured for a period); received not yet spent; received spent and not yet audited by the donor; and received spent, audited and confirmed as valid. Additionally revenue can also be received on a reimbursement basis and subject to audit by donors.

1.7 Some sources of revenue may be difficult to reliably measure. This includes services in-kind where there may be challenges in estimating the value of the services provided. For example, a volunteer from one jurisdiction may attract a rate of pay that is different to that in the jurisdiction where the volunteer provides services.

1.8 A further issue that occurs is whether revenues should always be reported on a gross basis or whether they can be reported on a net basis (after deducting expenses), for example, for fundraising activities.

1.9 Incorrect categorisation of incoming resources can lead to lack of transparency about the funds that an NPO can freely to apply to meet its expenses and the activities that the NPO is carrying out. This may be important to understanding how the NPO is performing.

2. Financial reporting challenges

2.1 NPOs may face a challenge to determine in which financial reporting period revenue is earned. Revenue may need to be deferred until performance obligations/ conditions are met. Judgements may be needed about the chances of having to refund revenue and when the likelihood of giving a refund diminishes from likely, to possible to unlikely. These judgements then need to be quantified in determining any liabilities arising from the present obligations created by the conditions.

2.2 Incoming resources are recognised when it is probable that the economic benefits (or service potential) associated with the transaction flow to the entity and the amount of revenue can be reliably measured. The NPO needs to have control over these resources. For some types of incoming resources (e.g. services in-kind) an NPO might need to put in additional systems to ascertain the amount of resource it controls. This may be challenging and a disproportionate cost.

2.3 Income from exchange transactions may be more easily measured being based on the transaction price on the transaction date. For non-exchange transactions deriving a value may be more challenging. A value needs to be determined at the date that the NPO obtains the incoming resources. Fair value would be the amount paid in an open market for an equivalent resource. This may be challenging if the value of the good or service is not immediately available/accessible. The cost of reliably measuring such incoming resources may exceed the benefit of the additional transparency, particularly where the value of the incoming resources is not material. This may be the case with services in-kind and the donations of goods (e.g. consumables that could be used by the NPO or high volume, low value second hand goods for resale).

2.4 Incoming resources may be a mix of exchange and non-exchange, may have conditions that appear to be too general to apply (and therefore not an effective constraint), have restrictions, or custom and practice may be that a particular contributor does not enforce the conditions that it imposes. Substance over form, materiality and cost benefit need to be considered.

2.5 Distinguishing between exchange and non-exchange transactions is important to understanding the source of funding for an NPO and transparency about the extent that revenue can be generally applied to an entity's expenditure. The presentation of revenue in the financial statements can show the extent to which an NPO is reliant on a particular source of funds, where funding has restrictions that limit its use or where the entitlement to revenue is dependent of meeting obligations. NPOs will need to assess each transaction to carry out this categorisation. Categorisation needs to best explain an NPO's revenue.

2.6 Challenges with financial reporting could be mitigated in part by additional disclosures, but these are likely to be at additional cost. Disclosures about material amounts or activities that are fundamental to the operations of the NPO and designed to enable the user to have visibility of the nature, amount, timing and uncertainty of revenue would aid understanding for all stakeholders.

2.7 With many types of incoming resources and many unique arrangements in the not for profit sector, these cannot be addressed by a single set of rules. Unless there are overarching principles or guidance NPOs will have no option but to determine its own accounting treatment. A set of principles for revenue recognition and measurement would help preparers in the judgements they make. Users of financial statements would benefit through more consistent approaches to new/unique but similar issues across the sector.

3. Current international guidance

3.1 Currently international guidance on incoming resources for external sources is included in the following standards[1]:

- IFRS 15 *Revenue from Contracts with Customers*

[1] There are a number of other standards that address revenue related accounting. This includes the accounting standards for leases (lease revenues), revenue from construction contracts (IPSAS only), insurance contracts, and provisions, contingent liabilities and contingent assets. These are not included in the discussion of this topic.

- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- Section 23 and section 24 *IFRS for SMEs*[2]
- IPSAS 9 *Revenue from Exchange Transactions*[3]
- IPSAS 23 *Revenue from Non-exchange Transactions* (Taxes and Transfers)

3.2 Generally the guidance provided by the standards is based on the core principle that revenue is recognised when it is probable that the entity will receive the economic benefits associated with the transaction and that it can be reliably estimated. This applies to revenue from exchange and non-exchange transactions.

3.3 All standards support the gross reporting of inflows of economic benefits received and receivable by the entity on its own account. They also all require initial measurement of revenues to be based on fair value, with exchange transactions measured at the consideration received (after discounts) and non-exchange transactions measured at the fair value at the date of acquisition, which may be ascertained by reference to an active market or by appraisal.

3.4 All standards require a minimum presentation of incoming resources. Further disclosures including the disaggregation of significant balances are required. For non-exchange transactions this goes to the nature and type of these transactions.

3.5 Neither IFRS nor IFRS for SMEs specifically address non-exchange transactions such as services in-kind. However, they do provide general recognition criteria for assets, liabilities, income and expenses, and the measurement bases to be adopted when recognition takes place.

3.6 IFRS 15 only considers transactions where consideration is paid for a good or service based on an agreed contract that has a commercial substance (exchange transactions). IFRS 15 permits revenue to be recognised once performance obligations have been satisfied, which can occur over time or at a single point in time.

3.7 IAS 20 provides guidance on the accounting of revenue from government grants. This standard requires that revenue from grants is only recognised where there is reasonable assurance that the entity will comply with any conditions and the grant will be received. This standard allows grant revenue provided for capital assets to be recognised over the life of the asset[4].

[2] The International Accounting Standards Board has initiated a programme to review IFRS for SMEs and in particular to consider updates for standards issued since the last update. This includes IFRS 15 *Revenue from Contracts with Customers.*

[3] The International Public Sector Accounting Standards Board has issued ED70, and ED71 to replace IPSAS 9 *Revenue from Exchange Transactions* to reflect IFRS 15, and a linked update of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

[4] This standard pre-dates the current IFRS conceptual framework and is not consistent with its principles.

3.8 IFRS for SMEs covers the recognition and measurement of revenue received from the sale of goods, the rendering of services, construction contracts and the use by others of entity assets yielding interest, royalties or dividends (exchange transactions). It also addresses the treatment of government grants (consistent with IAS 20). This standard does not include the concept of performance obligations but requires revenue to be recognised for services rendered and construction contracts based on the level of completion.

3.9 IPSAS 9 covers revenue from exchange transactions, and has the same coverage as IFRS for SMEs except construction contracts which are addressed in IPSAS 11 *Construction Contracts*. IPSAS 9 defines exchange transactions as: *'one in which the entity receives assets or services or has liabilities extinguished and directly gives approximate equal value (primarily in the form of goods and services, or use of assets) to the other party in exchange.'*

3.10 IPSAS 23 in its description of non-exchange transactions holds the opposite definition, in that the *'entity receives value <u>without</u> directly giving approximately equal value in exchange'*. This includes grants, debt forgiveness, bequests, gifts, donation and goods and services in-kind. Where conditions are attached to an inflow of resources a liability is raised being the present obligation arising as a consequence of the conditions. Where restrictions are attached to an inflow of resources, revenue may be recognised immediately. Services in-kind are not required to be recognised.

3.11 The IPSASB has recently published ED 70, *Revenue with Performance Obligations*, and ED 71, *Revenue without Performance Obligations*. Under these proposals, revenue from exchange transfers will be accounted for under ED70. Cash transfers with conditions to provide goods or services to the public would also be accounted for under ED 70, which is based on IFRS 15. Other cash transfers would be accounted for under ED 71. Revenue would be recognised when any conditions are met, with a liability recognised until this point. Unlike IPSAS 23, ED 71 does not require there to be a use or return requirement before revenue is deferred. In this respect, the proposals in ED 71 and the requirements in IFRS for SMEs are similar. ED 71 explicitly addresses cash transfers to acquire or construct a capital asset. It proposes that revenue from such cash transfers would be recognised as the asset is either procured or constructed.

4. <u>National-level guidance</u>

4.1 Annex A shows that there are similarities in the treatment of incoming resources in national-level guidance. Where national standard setters follow either IFRS or IPSAS standards the principles established in section three above largely apply in national standards. National standard setters can be converged on IFRS, IFRS for SMEs or IPSAS.

4.2 There is alignment across jurisdictions about the basis for recognition, which are consistent with international standards around the definition of an asset. In some jurisdictions recognition of defined non-exchange transactions are permitted in certain circumstances (e.g. services in-kind), but not required or only required to be recorded if they are significant donated assets. This guidance is based on materiality and pragmatism. In other jurisdictions, recognition is required where defined criteria are met.

4.3 One national standard setter provides specific guidance for different parts of the not for profit sector. It provides guidance on non-exchange transactions, distinguishing between grants received from government sources and revenue received from other sources. Government grants can be accounted for using either the accrual model (based on IAS 20) or the performance model (based on IFRS for SMEs). This may result in government grants and grants from other sources having a different accounting treatment.

4.4 Some jurisdictions require that incoming resources from non-exchange transactions separately identify those incoming flows that are restricted (i.e. can only be used to fund particular activities) and those that are unrestricted. One national standard setter permits restricted contributions to be recognised using a deferral method, where the contributions are recognised in the period related to the expenses or a restricted fund method income is recognised immediately, but is identified as part of a separate fund, which will also show the related expenses.

4.5 Some national standard setters are using decision trees to assist preparers in determining the categorisation and accounting treatment of revenue.

4.6 All national standard setters provide minimum categories for the presentation of revenue and either require or recommend additional disclosures for non-exchange transactions.

5. <u>Alternative financial reporting treatments</u>

5.1 Further discussion of recognition and measurement of incoming resources can be found in the following specific issue topics:

a) Cash transfers - donations, grants and other contributions with time and purpose requirements and other criteria/performance obligations – Chapter [x]
b) Services in-Kind (including volunteers) – Chapter [x]
c) Gifts in-Kind (non-financial assets and inventory) – Chapter [x]
d) Agency relationships – Chapter [x]

5.2 Establishing a framework for incoming resources may assist NPOs to navigate guidance and to assess the treatment of new transactions. The alternatives included are a 'do nothing' options which relies on NPOs navigating existing guidance or to establish a framework built on principles for revenue recognition and measurement specific to the NPO sector. This would include the use of decision trees to assist preparers in making judgements about how to categorise revenue.

	Description	Advantages	Disadvantages
Alternative 1 – follow IFRS or IFRS for SMEs with additional guidance	• For exchange transactions, NPOs would use the principles in IFRS for SMEs, unless currently following IFRS, in which case it would use IFRS 15. • Government grants that impose future specific performance conditions are only recognised when the performance conditions have been met. • Additional guidance for NPO specific issues with additional examples for each standard.	• No change for those for exchange transactions. • Can provide additional transparency by disclosing conditions and restrictions to incoming resources. • Can address materiality concerns and considerations of cost/ benefit	• Guidance on the recognition and measurement of non-exchange transactions might be limited given inconsistencies of treatments within current standards. • Additional cost to implement as may require the recognition donations and grants, and any related present obligations beyond existing standards • Additional disclosures could add to costs of preparing and auditing accounts
Alternative 2 – follow IPSAS[5] with additional guidance	• Use the principles of recognition and measurement of incoming resources that cover both exchange and non-exchange transactions. • Revenue is recognised from non-exchange transactions other than services in-kind. • An inflow of resources is recognised as revenue except to the extent that a liability is recognised in respect of the	• No change for exchange transactions • Provides consistent guidance on the recognition and measurement of exchange and non-exchange transactions • Increased transparency through information about non-exchange transactions • Can address materiality concerns and considerations of cost/ benefit	• May impact an NPOs ability to confirm that it is compliant with IFRS for SMEs • More costly to implement as requires the recognition and measurement of grants, donations and donations in-kind and any related present obligations • Additional disclosures could add to costs of preparing and auditing accounts

[5] Note that IPSAS 9 and IPSAS 23 are due to replaced, with Exposure Drafts 70 and 71 issued in February 2020. Guidance on non-exchange transactions remain (ED71) and exchange transactions are aligned with IFRS 15 *Revenue from Contracts with customers* (ED70)

	Description	Advantages	Disadvantages
	same inflow (due to a present obligation resulting from conditions). • Additional guidance for NPO specific issues with additional examples for each standard.	• Can provide additional transparency by disclosing restrictions to incoming resources.	
Alternative 3– Adopt an incoming resources framework to sit over international GAAP in addition to alternative 1 or 2 above.	• Set out principles of recognition, measurement and disclosure of incoming resources that cover the spectrum of NPO revenue to include both exchange and non-exchange transactions and address materiality and cost benefit. • Provide additional guidance to support the categorisation of incoming resources and their presentation, including decision trees.	• Provides an overarching framework to navigate which standards should be used for transactions rather than guidance for each standard. • Mitigates potentially inconsistent treatments for similar transactions across the sector. • Other advantages as above.	• Another piece of guidance for users to navigate in addition to the standards • Other disadvantages as above.

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Specific Matters for Comment

Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.

Please identify the alternative treatment that you favour, and the reasons for your view.

[Draft generic questions for further discussion]

Annex A – Recognition and Measurement of incoming resources from external sources

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 1 – follow IFRS or IFRS for SMEs with additional guidance	Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity and can be reliably measured (IFRS for SMEs). IFRS 15 requires that revenue is recognised in accordance with performance obligations. IAS 20 and IFRS for SMEs require government grants to be recognised when conditions are met.	Convergence between IFRS for SMEs and FRS 102. Recognition depends on whether there are performance-related conditions. Income is recognised as the conditions are met. Restrictions do not prohibit recognition. There can be a difference in the treatment of capital grants depending on whether they are government grants, or another grantor.	Convergence with IFRS 15 for exchange transactions. Australian specific standard for non-exchange transactions. Establishes principles for not-for-profit entities to apply to transactions where the consideration is significantly less than the fair value principally to enable a not-for-profit to further its objectives and the receipt of volunteer services. Volunteer services are not required to be recognised.			

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 2 – follow IPSAS[6] with additional guidance	Revenue from exchange transactions are recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity and can be reliably measured. (IPSAS 9) Non-exchange transactions follow the same principles. A liability should be recorded when there is a present obligation arising from conditions attached to incoming resources. There is no present obligation for an asset with a restriction.			Convergence with IPSAS 9 and IPSAS 23 for exchange and non-exchange transactions		
Alternative 3– Adopt an incoming resources framework to sit over international GAAP in		The charities SORP, Section 5 gives more detailed guidance on the recognition of income including types of income and		Separate standard for Tier 3 entities based on IPSAS. Provides detailed guidance on the	Guidance is provided to assist stakeholders in determining whether a contribution is	There is no specific NFP guidance for exchange transactions.

[6] Note that IPSAS 9 and IPSAS 23 are due to replaced, with Exposure Drafts 70 and 71 issued in February 2020. Guidance on non-exchange transactions remain (ED71) and exchange transactions are aligned with IFRS 15 *Revenue from Contracts with customers* (ED70)

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
addition to alternative 1 or 2 above.		terms and conditions that may, or may not, restrict recognition as income. Income should be recognised when there is entitlement, it is probable the benefits will flow to the charity and it can be measured reliably. The charities SORP requires detail on the reasons for and analysis of deferred income.		recognition and measurement of specific inflows.	restricted or unrestricted. Restricted contributions are recognised either under the deferral method or restricted fund method. Under the deferral method restricted contributions related to expenses in future periods are deferred to the period in which the related expenses are incurred. Under the restricted fund method, where contributions for which a corresponding restricted fund is presented should be recognized as revenue of that fund in the current period. Restricted contributions for which no corresponding restricted fund is presented should be	Contributions and promises to give must be un-conditional to be recognised. There is detailed guidance about "donor-imposed conditions" which include a barrier to be overcome and either a right of return of assets or a right of release of a promisor's obligation to transfer assets. Conditional contributions are treated as refundable until conditions have been substantially met or explicitly waived by the donor. Conditional promises to give are disclosed. Once deemed unconditional, entities consider whether the contribution is restricted by donors.

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
					recognized in the general fund in accordance with the deferral method. An organization must select one method and apply it to all contributions.	Services in-kind are *only* recognized if they create or enhance nonfinancial assets and/or require specialized skills. Guidance recognises that revenue may be contributions, exchange transactions, or a combination of both.
Standards References	IFRS 15 *Revenue from Contracts with Customers*, IPSAS 9 *Revenue from Exchange Transactions*, IFRS for SMEs section 23.	FRS 102 Section 34 *Incoming Resources from Non-exchange Transactions, (PBE 34.64-PBE 34.74)*, Appendix B *Guidance on incoming resources from non-exchange transactions*, FRS 102 Section 24 *Government Grants,* Charities SORP (FRS 102) (Second Edition) Section 5 *Recognition of income, including legacies, grants and contract income*	AASB 15 *Revenue from Contracts with Customers* AASB 1058 *Income of Not-For-Profit Entities*	PBE IPSAS 9 *Revenue from Exchange Transactions* and PBE IPSAS 23 *Revenue from Non-Exchange Transactions* for Tier 1 and 2 entities	CPA Canada Handbook - Accounting, Section 4410, *Contributions – revenue recognition* and the CPA Canada Public Sector Accounting Handbook, PS 4210, *Contributions – revenue recognition*	Recognition guidance for contributions received and promises to give are in ASC Subtopic 958-605-25