

Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGED08-03

14 December 2022 – Virtual

Revenue

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| Summary | This paper summarises factors being considered about the structure of the INPAG revenue sections in ED2. |
| Purpose/Objective of the paper | The TAG have had an initial discussion on the proposed way forward on the revenue content for inclusion in ED2. The TAG agreed that there were two possible ways to structure the content on revenue. The purpose of this paper is to seek feedback from the PAG on the options being developed. |
| Other supporting items | None |
| Prepared by | Paul Mason/Karen Sanderson |
| Actions for this meeting | <p>Advise on:</p> <ul style="list-style-type: none"> • The pros and cons of a single chapter on revenue as distinct from two separate chapters. • Terminology |

Technical Advisory Group

Revenue

1. Background

- 1.1 The recognition and measurement of revenue has been identified as a specific issue for non-profit organisations. This paper summarises the feedback to the Consultation Paper and the current standard setting landscape on revenue. This provides important context for the development of the Guidance.
- 1.2 The Consultation Paper only considered non-exchange revenue as no sector specific issues regarding exchange revenue (revenue from commercial type arrangements) were identified. As a recap the Consultation Paper summarised the financial reporting challenges for NPOs as follows:

| Issue | Cash Transfers | Gifts In-Kind | Services In-Kind |
|------------------------------------|---------------------|---------------------|---------------------|
| Recognition - control | Medium significance | High significance | High significance |
| Recognition - reliable measurement | Low significance | High significance | High significance |
| Recognition - timing | High significance | Medium significance | Medium significance |
| Measurement | Low significance | High significance | High significance |
| Disclosure | High significance | High significance | High significance |

Key: ■ High significance ■ Medium significance ■ Low significance

2. Consultation Paper Responses

- 2.1 An analysis of the consultation responses can be found in Annex A with more detailed analysis in TAGED08-01 *Revenue*. In summary, of those respondents that discussed the question, over 80% agreed with the description of the issue on non-exchange revenue and over 70% considered that the list of alternatives was exhaustive. Comments made included the following:
- Government and non-government grants should be accounted for in the same manner.
 - Do not distinguish between exchange and non-exchange revenue. Instead distinguish between revenue with performance obligations and other revenue.
- 2.2 While there was no consensus as to the preferred alternative, a significant majority of respondents favoured alternatives that use a performance approach (i.e., that recognise revenue as performance conditions are satisfied) rather than deferring

revenue to match expenditure. A number of responses suggested an approach based on the accounting proposed in the IPSASB's recent EDs on revenue, which also propose to recognise revenue as performance conditions are satisfied.

- 2.3 There was clear support for the inclusion of exceptions for gifts in-kind and services in-kind, due to the practical difficulties some NPOs would experience, particularly if the relevant information systems were not in place.
- 2.4 There was little consensus about the circumstances in which gifts and services in-kind should be recognised, and how they should be measured. Different types of gifts in-kind generated different views.
- *Donations of fixed assets.* Acceptance that these should be recognised because of their significance.
 - *Goods donated for resale.* In general support for permitting revenue from goods donated for resale to be recognised when the items were sold.
 - *Goods donated for use or onward distribution.* There were different views as to whether revenue (and the related expenses) from such items should be recognised.
 - *Donated services.* There was a significant (but not universal) acceptance that measuring the value of services in-kind could be difficult, and that this could justify permitting NPOs to not recognise revenue (and matching expenses). However, recognising services in-kind would ensure comparability between NPOs.
- 2.5 Responses highlighted the need for guidance on the distinction between conditions and restrictions, and for the need to address non-performance conditions (such as time) as well as performance conditions.
- 2.6 Disclosures were identified as being essential to understanding the financial statements, for example in relation to the use of exceptions and in distinguishing income from grants with capital or operational purposes.
- 2.7 Respondents identified a number of practical issues. These included measurement of gifts in-kind, measurement of services in-kind, transactions that have exchange and non-exchange elements, non-performance conditions and capacity building.

3. Developments in international financial reporting standards

IASB

- 3.1 The IASB issued its Exposure Draft for the third edition of the *IFRS for SMEs* Accounting Standard, for consultation on 8 September 2022. Section 23, Revenue from contracts with customers, is now based on the principles in IFRS 15. This revised

section, at 129 paragraphs, appears significantly more detailed than most other sections within the *IFRS for SMEs Accounting Standard*. Section 24, Government grants, addresses accounting for non-exchange transactions but only for government grants. This section (which contains 7 paragraphs) sets out the high-level principles to be followed.

- 3.2 With the basis of exchange revenue in Section 23 now based on IFRS 15, it is likely to have relevance in developing guidance for non-exchange transactions as it considers performance obligations. The terminology used in Section 23 differs from that in Section 24 (for example, Section 24 refers to performance conditions whereas Section 23 refers to promises in a contract), but the underlying principles are the same. The requirements of Section 23, which adopts the same five step model as found in IFRS 15 are summarised below.

Step 1: Identify the contract(s) with a customer

Step 2: Identify the promises in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the promises in the contract

Step 5: Recognise revenue when (or as) the entity satisfies a promise

IPSASB

- 3.3 The IPSASB issued two Exposure Drafts (EDs) in February 2020; ED 70, *Revenue with Performance Obligations* and ED 71, *Revenue without Performance Obligations*. Since then, the IPSASB's thinking has evolved, and a single IPSAS covering all revenue is now being developed. The current proposals make the distinction between revenue that arises from transactions with a binding arrangement and those without a binding arrangement.
- 3.4 The new IPSAS being developed proposes that revenue from transactions without a binding arrangement is recognised immediately (ie on receipt) in surplus or deficit. For revenue from transactions with binding arrangements, the IPSASB proposal adapts the five-step model in IFRS 15 to apply to a wider range of obligations, referred to as compliance obligations.
- 3.5 These proposals define a compliance obligation as "*an entity's promise in a binding arrangement to either use resources internally for distinct goods or services or transfer distinct goods or services to a purchaser or third-party beneficiary.*" Compliance obligations in the IPSASB proposals may be closer to the performance conditions in Section 24 of the *IFRS for SMEs Accounting Standard* than the promises in Section 23, as the promises in Section 23 require a transfer of distinct goods or services.
- 3.6 The draft new IPSAS includes additional or modified guidance compared to IFRS 15, some of which may be useful in developing INPAG. Key areas of additional or modified guidance include:

- Identifying compliance obligations – it covers the identification of distinct goods or services acquired or developed by the recipient.
 - Recognition of a liability - requirement that where an entity receives funds prior to satisfying its compliance obligations, this will give rise to a liability.
 - Satisfaction of a compliance obligation - guidance on the use of resources internally that are satisfied over time or at a point in time.
 - Allocating the transaction consideration to compliance obligations - requirement that the transaction consideration is to be allocated to compliance obligations in proportion to their stand-alone value. The guidance specifically notes that the stand-alone value for a distinct good or service for internal use will be the price the entity would pay to acquire that good or service.
- 3.7 While the additional guidance in the draft new IPSAS may be helpful in developing INPAG, it should be noted that the level of complexity is comparable with IFRS 15. Consequently, while the approach taken in the new draft IPSAS may be helpful, INPAG would need to be simplified and adapted if this is used to develop the Guidance. A new exposure draft is likely to be issued in Spring 2023.

4. Developing INPAG

- 4.1 As a result of the amendments proposed to both the *IFRS for SMEs* Accounting Standard and IPSAS, the underlying principles under all three international frameworks for revenue are likely to be similar, and based on satisfying performance conditions.
- 4.2 At the September 2022 TAG meeting, the TAG considered the way forward in the light of the responses to the Consultation Paper and the current standard setting landscape. The TAG were asked for views on developing a single revenue Section, with non-exchange transactions integrated with other revenue transactions or to continue the differentiation made in the *IFRS for SMEs* Accounting Standard between Revenue (exchange transactions) and Government Grants (non-exchange transactions).
- 4.3 A two Sections approach was described where the requirements for revenue accounting would be set out in a section on self-generated revenue (exchange revenue) and a separate section on grants and donations (non-exchange revenue). Exchange revenue could be based on Section 23 of the *IFRS for SMEs* Accounting Standard, while the requirements for non-exchange revenue could take the principles in Section 24 with additional guidance where necessary. Cross-references to Section 23 could be made to avoid duplication and additional guidance based on the draft new IPSAS could be included where helpful. However, cross-references could be difficult to follow, especially where there is additional NPO-specific guidance in Section 24. Also the requirements in Section 23 may be overly complex for non-exchange revenue.

- 4.4 Instead of cross referencing between Section 23 and Section 24, Section 24 could be replaced completely with guidance taken from Section 23 where this is relevant and then supplemented by additional guidance from the draft new IPSAS. This would mean that all the guidance for non-exchange transactions was in one place, but would likely mean extensive duplication.
- 4.5 Alternatively another approach was described, similar to the IPSAS proposals, where INPAG could include a single set of requirements covering both exchange and non-exchange revenue. This would replace the text of both Sections 23 and 24 from the *IFRS for SMEs Accounting Standard* into a single new Section.
- 4.6 The TAG did not reach a decision at the September meeting and asked for further information to be provided on the advantages and disadvantages of the different approaches. Additional analysis is being prepared for consideration by the TAG in January. This will also reflect the feedback to the Consultation Paper. The main points arising in the analysis to date are summarised in the table below.

| | Single Section approach | Two Section approach |
|---------------|---|---|
| Advantages | <ul style="list-style-type: none"> • Guidance in one place • NPOs don't have to decide whether revenue is exchange or non-exchange • Guidance likely to be shorter in length | <ul style="list-style-type: none"> • Simpler for those NPOs that only have grants and donations • No amendments to Section 23 |
| Disadvantages | <ul style="list-style-type: none"> • May appear more complex particularly for NPOs that only have grants or donations • Additional work as both Section 23 and Section 24 impacted | <ul style="list-style-type: none"> • Likely to be duplication resulting in a longer document and potentially cross referencing between Sections • More complex for revenue that has an exchange and non-exchange element as NPOs will need to access both Sections • Need to decide which Section to use based on the type rather than nature of the revenue |

Question 1: What are the PAG’s views on a single Section or a two Section approach in terms of the ease of use by NPOs and the understandability of how to account for revenue?

- 4.7 Irrespective of whether a one or two Section approach is adopted, it is proposed to develop the additional guidance based on the terminology being used in the IPSAS proposals. As already noted, these proposals no longer make the distinction between exchange and non-exchange revenue, but focus instead on revenue with or without a binding arrangement. If a two Section approach is followed the revenue sections would be called ‘Self-generated revenue’ and ‘Grants and donations’. If a single Section approach is followed the revenue section would be called ‘Revenue’. PAG have previously expressed concerns about the understandability of the term ‘non-exchange revenue’, which would not be used although the term ‘non-exchange transaction’ may be used elsewhere in INPAG to describe those transactions where one party does not directly receive something of approximately equal value in return.

Question 2: What are the PAG’s views on the proposal not to use non-exchange revenue, but to retain non-exchange transaction, within the INPAG literature?

Question 3: What are the PAG’s views on the proposed Section titles?

- 4.8 If the IPSAS approach is taken two of the key terms will be ‘binding arrangement’ and ‘compliance obligation’. These terms are also proposed to be used in the Section on grant expenses. The definitions are as follows:

Binding arrangement: *“an arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on the parties to the binding arrangement.”*

Compliance obligation: *“an entity’s promise in a binding arrangement to either use resources internally for distinct services, goods or other assets or transfer distinct services, goods, cash or other assets to a purchaser or third-party beneficiary.”*

Question 4: What are the PAG’s views on the understandability of the terms proposed for the development of revenue within INPAG?

- (i) Binding arrangement
- (ii) Compliance obligation

December 2022



Annex A: Detailed Responses to Specific Matters for Comment

| Question | Response | Number | % | % Responded |
|---|----------------------------|-----------|-------------|-------------|
| SMC 3(a) Do you agree with the description of issue 3 – Non-exchange revenue? – in the Consultation Paper? If not, why not? | Agree | 22 | 32% | 81% |
| | Disagree | 4 | 6% | 15% |
| | Neither Agree nor Disagree | 1 | 1% | 4% |
| | <i>Non-Response</i> | 42 | 61% | |
| TOTAL | | 69 | 100% | 100% |
| SMC 3(b) Do you agree that the list of alternative treatments that should be considered for issue 3 is exhaustive? If not, please describe your additional proposed practical alternatives, and explain why they should be considered. | Agree | 20 | 29% | 71% |
| | Disagree | 8 | 12% | 29% |
| | Neither Agree nor Disagree | 0 | 0% | 0% |
| | <i>Non-Response</i> | 41 | 59% | |
| TOTAL | | 69 | 100% | 100% |
| SMC 3(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 3? If you do not agree, please set out the changes you propose, and why these should be made. | Agree | 20 | 29% | 77% |
| | Disagree | 6 | 9% | 23% |
| | Neither Agree nor Disagree | 0 | 0% | 0% |
| | <i>Non-Response</i> | 43 | 62% | |
| TOTAL | | 69 | 100% | 100% |



INTERNATIONAL FINANCIAL REPORTING FOR NON PROFIT ORGANISATIONS

| Question | Response | Number | % | % Responded |
|--|----------------------------|-----------|-------------|-------------|
| SMC 3(d) Please identify the alternative treatment that you favour for issue 3, and the reasons for your view. | Alternative 1 | 7 | 10% | 27% |
| | Alternative 2 | 3 | 4% | 12% |
| | Alternative 3 | 0 | 0% | 0% |
| | Alternative 4 | 9 | 13% | 35% |
| | Multiple Alternatives | 3 | 4% | 12% |
| | None | 4 | 6% | 15% |
| | <i>Non-Response</i> | | 43 | 62% |
| TOTAL | | 69 | 100% | 100% |
| SMC 3(e) If you favour an alternative other than alternative 4 for issue 3, do you consider that the exceptions to the recognition and measurement of gifts in-kind and services in-kind should be available under your preferred option? | Agree | 15 | 22% | 88% |
| | Disagree | 2 | 3% | 12% |
| | Neither Agree nor Disagree | 0 | 0% | 0% |
| | <i>Non-Response</i> | | 52 | 75% |
| TOTAL | | 69 | 100% | 100% |
| SMC 3(f) Are there any practical considerations, for example impacts on tax or audit thresholds, or questions that arise in implementing your preferred option for issue 3? | Agree | 17 | 25% | 77% |
| | Disagree | 5 | 7% | 23% |
| | Neither Agree nor Disagree | 0 | 0% | 0% |
| | <i>Non-Response</i> | | 47 | 68% |
| TOTAL | | 69 | 100% | 100% |