



# Practitioner Advisory Group (PAG) Issue Paper

AGENDA ITEM: PAGED07-01

12 September 2022 – Online

## Non-exchange revenue

Summary	This paper outlines some of the key issues for the development of INPAG relating to non-exchange revenue (grants and donations).
Purpose/Objective of the paper	To allow PAG members to consider the practical issues associated with these issues that will need to be considered in developing the non-exchange revenue section of INPAG.
Acronyms	<ul style="list-style-type: none"><li>• INPAG: International Non-Profit Accounting Guidance, the guidance being developed by the IFR4NPO project.</li><li>• NPO: Non-profit Organisation</li><li>• IPSAS: International Public Sector Accounting Standard</li><li>• IAS: International Accounting Standard</li><li>• ED: Exposure Draft</li><li>• TAG: Technical Advisory Group</li></ul>
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Actions for this meeting	Advise on: <ul style="list-style-type: none"><li>• The operation of performance conditions</li><li>• Time constraints</li><li>• Exceptions for services in-kind</li><li>• Exceptions for grants in-kind</li><li>• Use of exceptions</li></ul>

# Practitioner Advisory Group

## Non-exchange revenue

### 1. Consultation Paper proposals

- 1.1 This paper covers non-exchange revenue, which the Consultation Paper explains “arises when an entity receives value from another entity without directly giving approximately equal value in exchange.”
- 1.2 Non-exchange revenue is a term that is used in public sector accounting standards to cover those revenues that are not for the sale of a good or service. For example tax revenues that are paid to governments are a non-exchange revenue as citizens do not necessarily get something directly of equal value in return for the taxes they pay. The same is true of donations and grants where the provider of those revenues do not necessarily get something directly of equal value in return – they provide these revenues for the benefit of others.
- 1.3 Whilst the term seems applicable, it is not a term that is currently well understood by non-profit organisations. It is helpful to have a collective term for such types of income so that the application of the principles can be better understood.

**Question 1:** Does the term ‘non-exchange revenue’ fit these type of NPO transactions? Is there an equivalent term that might be better understood?

- 1.4 The Consultation Paper proposed four alternative financial reporting treatments for developing guidance for accounting for non-exchange revenue. These were:
- 1.5 **Alternative 1** requires all non-exchange revenue to be recognised in accordance with the *IFRS for SMEs* Accounting Standard. This would mean for non-exchange revenue other than government grants, that the Concepts and Pervasive Principles would be used to apply to other non-exchange transactions (i.e., NPOs would be required to recognise revenue from services in-kind and gifts in-kind where they can be reliably measured). Alternatively, the government grants requirements could be applied to other non-exchange revenue, as this is likely to result in similar accounting.

- 1.6 **Alternative 2** requires non-exchange revenue to be recognised using the principles in IAS 20 to extend the treatment of government grants to other non-exchange revenue (i.e., to recognise revenue on a systematic basis over the periods that the entity recognises as expenses the related costs). As with alternative 1 in applying these principles NPOs would be required to recognise revenue from services in-kind and gifts in-kind that can be reliably measured.
- 1.7 **Alternative 3** requires non-exchange revenue to be accounted for using the principles in IPSAS 23 (i.e., revenue is usually recognised when an NPO controls the assets but is deferred where there are conditions). The recognition of revenue from services in-kind would be encouraged but not mandatory. Gifts in-kind would be required to be recognised where they can be reliably measured.
- 1.8 **Alternative 4** requires non-exchange revenue to be accounted for using the principles in IPSAS. In addition, exceptions drawn from various national standards would be considered for inclusion as part of NPO-specific guidance. The exceptions could:
- Permit NPOs to recognise revenue from gifts in-kind donated for resale at point of sale rather than on receipt.
  - Permit NPOs to not recognise inventory or revenue on receipt of gifts in-kind donated for distribution.
  - Permit NPOs to recognise revenue and an expense when items are distributed or used to provide services.
  - Require additional disclosures where an NPO uses a permitted exception.
- 1.9 A specific matter for comment sought views on whether the exceptions proposed in Alternative 4 should be available in the other alternatives.

## 2. Responses to Consultation Paper

- 2.1 While there was no consensus as to the preferred alternative, the preferences in the responses to the Consultation Paper, along with the comments made, do provide an indication of the overall approach preferred by respondents:
- Of those responses that specifically addressed this issue, a significant majority favour alternatives that use a performance approach (i.e., that

recognise revenue as performance conditions<sup>1</sup> are satisfied) rather than deferring revenue to match expenditure. Of those responses that expressed a preference, 35% supported Alternative 4 (based on IPSAS, which recognises non-exchange revenue as conditions (which must include a use or return condition) are satisfied); 27% supported Alternative 1 (based on the *IFRS for SMEs* Accounting Standard, which recognises government grants as performance conditions are satisfied); and only 12% supported Alternative 2 (based on IFRS, which defers government grant revenue to match expenditure).

- In addition, most of the responses that expressed a preference for multiple alternatives suggested a combination of Alternatives 1 and 4; and a number of responses that did not support any option suggested an approach based on the accounting proposed in the IPSASB's recent EDs on revenue, which also recognise revenue as performance conditions are satisfied. It should be noted that most responses did not distinguish between conditions under IPSAS 23 (where a "use or return" condition must be present) and conditions under the *IFRS for SMEs* Accounting Standard and the IPSASB EDs (where a "use or return" condition is not required)<sup>2</sup>.
- Respondents clearly supported the inclusion of exceptions for gifts in-kind and services in-kind whichever alternative was adopted. This was due to the practical difficulties some NPOs would experience, particularly if the relevant information systems were not in place. Some responses also considered that the use of the exceptions would assist with the cost/benefit analysis.

2.2 Further details of the responses to this section of the Consultation Paper will be presented to the TAG at its September meeting.

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<sup>1</sup> This paper uses the term 'performance conditions', as this is the term used in the *IFRS for SMEs* Accounting Standard. The equivalent term used in the draft new IPSAS is 'compliance obligations' while the terms 'restrictions' and 'conditions' are used in IPSAS 23. The question of which term should be used will be considered by the TAG.

<sup>2</sup> One response did note that in the UK a condition that allows for the recovery, in certain circumstances, of a resource by the giver does not necessarily prevent the recognition of revenue if repayment is not probable, and that this approach is generally considered to work well in practice.

### 3. Way forward

- 3.1 As noted above, TAG has not yet considered the analysis of the responses and the potential way forward. The INPAG secretariat are currently of the view that where donations and grants have conditions imposed by the funder, the non-exchange revenue section of INPAG should be developed using the performance approach. PAG members' views are sought on a number of issues that will need to be addressed in developing the guidance.
- 3.2 There is little disagreement that where an NPO receives donations and grants without any constraints on their use, revenue should be recognised when the donations are received (or become receivable, if this is earlier). This paper therefore seeks PAG members' views on cases where funding agreements impose some form of constraints over how their grants and donations can be used.

#### *Performance conditions*

- 3.3 The INPAG secretariat, in line with the respondents' views, does not support the recognition of revenue on a systematic basis over the periods in which the related expense is recognised (the IAS 20 approach) because this approach would require deferred amounts to be recognised as liabilities. As these amounts do not meet the definition of a liability in Section 2, the INPAG Secretariat do not believe that this is an appropriate way forward.
- 3.4 Two main variants of the performance condition approach exist in current international standards. Under IPSAS 23, there must be a 'use or return' condition in the funding agreement for a performance condition to exist (i.e., the funding agreement must require the recipient to return funds to the donor if the recipient does not comply with the performance conditions in the agreement). This is not the case under the approach for government grants in the *IFRS for SMEs Accounting Standard*.
- 3.5 The INPAG Secretariat is of the view that performance conditions can exist without the existence of a 'use or return' condition in the funding agreement. An NPO may have a liability if the funder can enforce performance, regardless of whether the agreement includes a 'use or return' condition. This approach is consistent with the IPSASB's latest thinking as set out in Exposure Drafts (EDs) 70 and 71 and subsequent agenda papers. Some users of IPSAS 23 have commented that requiring a 'use or return' condition can lead to revenue being recognised immediately in circumstances where deferral is more appropriate.

**Question 2:** What views do PAG members have on the definition of a performance condition? Do PAG members agree that the use of performance conditions in INPAG should not refer to 'use or return' conditions?

### *Time constraints*

- 3.6 Some donations and grants may be provided with a constraint that they are to be used in a specific time period, but with no further constraints. There is a question as to whether such constraints are performance conditions. This question arises because an NPO could incur expenses and determine at a later date whether to fund the expenses from its general funding, from the donations or grants, or from a mixture of the two.
- 3.7 If the time constraint is not a performance condition, revenue would be recognised immediately, if it is only revenue with performance conditions that can be recognised in a later period. The donation or grant would be presented in the financial statements as income with restrictions, but revenue recognition would not be deferred.

**Question 3:** What practical issues do PAG members consider should be considered in accounting for time constraints?

### *Exceptions to the recognition and measurement principles*

#### *Services in-kind*

- 3.8 IPSAS 23 permits, but does not require, entities to recognise services in-kind. This approach is adopted because of the difficulties with identifying and measuring services in-kind, especially where the services provided would not otherwise have been purchased.
- 3.9 Some national standards require services in-kind to be recognised as revenue in specific circumstances
- Where the services would otherwise be purchased (revenue and an expense are recognised).
  - Where the services involve skilled or professional labour that would otherwise be purchased (revenue and an expense are recognised).

- Where the services involve the creation of a non-current asset (revenue and an element of the cost of the asset are recognised).
- 3.10 The INPAG secretariat is minded to support the adoption of the approach in IPSAS 23 where NPOs are permitted but not required to recognise services in-kind as revenue.
- 3.11 The INPAG secretariat acknowledges that there may be merit in requiring the recognition of services in kind in some or all of the specific circumstances identified in national standards (see paragraph 3.9), and is seeking the views of PAG members on the benefits and challenges if recognition is required in some or all of these cases.

**Question 4:** Do PAG members think that INPAG should permit but not require recognition of revenue from services in-kind in all circumstances? Are there circumstances where recognition of services in-kind would be beneficial? If so, when? What are the practical challenges?

#### *Gifts in-kind*

- 3.12 IPSAS 23 requires all gifts in-kind to be recognised and measured in accordance with that Standard. However, some national standards provide exceptions for certain types of gift in-kind, and respondents to the Consultation Paper supported including these exceptions in INPAG.
- 3.13 The INPAG secretariat supports the inclusion of the exceptions, and proposes the following treatments:
- **An NPO receives a non-current asset (for example, a vehicle or building)** – the NPO should recognise the asset and measure it at fair value, with no exception being permitted due to the significance of the asset received.
  - **An NPO receives items for resale** – where the items received are high volume, low value items, the NPO should be permitted to not recognise revenue (and therefore not recognise the items as inventory) on receipt, but instead to recognise revenue if and when the items are subsequently sold. If the NPO receives high value items for resale, these should be recognised as revenue on receipt, in the same way as gifts of non-current assets would be recognised as revenue.



- An NPO receives items for distribution to beneficiaries or for its own use (whether for delivering services or for administration purposes) – the NPO should be permitted not to recognise revenue (and therefore not recognise the items as inventory) on receipt, but instead to recognise revenue and an expense if and when the items are subsequently distributed or used.

**Question 5:** Do PAG members consider the proposed treatment of gifts in-kind appropriate for NPOs?

*Use of exceptions*

- 3.14 Recognising and measuring all services and gifts in-kind as revenue in accordance with the overall approach (i.e., without permitting any exceptions) would provide the most information for users. It is important to consider the usefulness of this information to the users of NPO's general purpose financial reports.
- 3.15 The reason for permitting exceptions is to avoid the costs to NPOs outweighing the benefits to users of the NPO's financial statements. This balance could be achieved by permitting all NPOs an accounting policy choice of whether to recognise these donations. Alternatively, use of the exceptions could be permitted only where this would satisfy the criteria for an 'undue cost or effort exemption'. NPOs would therefore need to recognise services and gifts in-kind unless the cost or effort involved in providing the information substantially exceeds the benefits to the users of the financial statements.
- 3.16 Different approaches may be appropriate for the various exceptions being considered; for example, permitting an accounting policy choice for services in-kind but only permitting an 'undue cost or effort exemption' for gifts in kind.

**Question 6:** Are there circumstances where NPOs should be able to rely on exceptions to the recognition and measurement requirements rather than it being a matter of accounting policy choice?

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