Accounting for Revenue and Non-Exchange Expenses
Comments of Ichabod's Industries on the Consultation Paper

Ichabod's Industries is an accountancy consulting firm that provides technical accounting support to a number of local government bodies in the United Kingdom. We have also been commissioned a regular basis to draft guidance for the Chartered Institute of Public Finance and Accountancy on the application of IFRS 9 *Financial Instruments* and the Group Accounts standards by UK local authorities.

UK local authorities have not generally applied IPSASs, but the provisions of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* have been adopted for grant income.

We wish to contribute to discussion on **Specific Matter for Comment 3**.

The Code of Practice on Local Authority Accounting in the UK adopts the provisions in IPSAS 23 that a liability is recognised in relation to a grant (and recognition of revenue is consequently deferred) only where a condition remains outstanding which would result in future economic benefits or service potential being returned to the transferor if it is not met. Particularly with a recent propensity for central government to distribute surplus funds to local government at the end of the financial year, but with a proviso that they are not spent until the next year, we have had a substantial problem of presenting revenue balances accruing at the year-end which were not capable of being applied at that date.

The solution CIPFA arrived at was a recommendation in the guidance notes to the Code that authorities earmark the balances – ie, per Option (b) in paragraph 4.14 of the consultation. However, there has been dissatisfaction that resources with clearly distinguishable applicability can only be distinguished presentationally and not by a distinctive accounting policy.

One possibility that isn't discussed in the consultation is that IPSAS 23 is too narrow in its interpretation that a liability can only be recognised if the transferor has a right of return if conditions are not met. The definition of a liability in the IPSASB Conceptual Framework as "a present obligation of the entity for an outflow of resources that results from a past event" is wider than that applied in IPSAS 23, where the possible outflow of resources is restricted only to the transferor who gave them to the entity.

Our view is that if the liability definition were applied comprehensively to cover any outflow of resources, then it must be implicit in the recognition of any grant payment with stipulations as an asset that a corresponding liability would arise. This is because a receipt of grant would only be recognisable as a resource for an entity if it by implication makes a commitment to meet the stipulations against which the grant has been paid – ie, it commits

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to outflows of resources in the form of payments to employees, payments for goods and services, grants to others, etc, in accordance with the transferor's stipulations. Without this implicit commitment, the grant payment has no status as a resource, and is just a balance of cash to be held in perpetuity. A liability in the form of a commitment to incur expenditure in compliance with the stipulations is therefore fundamental to any claim that the grant will be a resource for the authority (with this implicit commitment to future expenditure being the past event).

In short, where a grant is given with stipulations, an entity should not technically be able to recognise an asset without recognising a liability (and thus deferring recognition as income for some or all of the cash receipts until the stipulations are met).

A more comprehensive definition of conditions to reflect the full range of possible cash outflows to which an entity might be committed would resolve the issues about time requirements. It would also remove any unease that might be felt that, whilst stipulations remain unmet, the transferor of resources is substantially directing how the grant receipts can and cannot be spent and the entity cannot be said to have a control over the resource.

There would therefore be a new proposal to be made under Approach 1 – revisit the restrictive definition of conditions in IPSAS 23 and expand it so that it is consistent with the liabilities definition in the Conceptual Framework.

There is also the potential that this sort of thinking could also resolve the issues about capital grants, if the focus on outflows of economic benefits is shifted from the payments for the acquisition or construction of a capital asset (which doesn't need to be resourced, because under proper practices this is achieved through depreciation) to the consumption of the capital asset in the provision of services.

We are therefore suggesting a different focus for Specific Matter for Comment 3 – none of the options for applying Approach 1 would be as effective as bringing the definition of conditions in line with the Conceptual Framework. Option (b) does part of the job, but if further thought is given as to why it might be reasonable it should become clear that it is doing so by partly addressing the a flaw in IPSAS 23 that could be more widely addressed to resolve other issues.

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