PREFACE

The objective of the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) is to develop programs aimed at improving public sector financial management and accountability. To that end, the IFAC PSC issues Guidelines, Statements on Practice, and Studies. Studies are undertaken by the Committee to provide information that contributes to public sector financial reporting, accounting or auditing knowledge and to stimulate discussion.

In March 1991, the IFAC PSC issued Study 1, *Financial Reporting by National Governments*. That Study considered the objectives of the financial reports of national governments and their major units, and the extent to which those objectives are met by different bases of accounting and different reporting models.

In July 1993, the IFAC PSC issued Study 2, *Elements of the Financial Statements of National Governments*. That Study identified the elements of financial statements (that is, the types or classes of information that may be reported in financial statements), considered the extent to which those elements would be reported under different bases of accounting and noted the implications of reporting particular elements or sub-sets thereof for the messages communicated by financial statements and the achievement of the objectives identified in Study 1.

This Study extends Study 1 and in particular Study 2. It is a companion to Study 5, *Definition and Recognition of Assets*, Study 6, *Accounting for and Reporting Liabilities*, and Study 10, *Definition and Recognition of Expenses/Expenditures*, all of which examine in greater detail accounting and reporting issues related to specific elements of the financial statements. This Study considers and explores current views held internationally on:

(i) the definition and recognition of revenues;

(ii) the effect of different bases of accounting on the definition and recognition of revenues; and

(iii) the particular issues and problems arising from certain types of revenues.

The Study begins by defining exchange revenues before moving on to address non-reciprocal revenues and their recognition. It also deals with the aspects of those revenues specific to the public sector.

A major revision of public sector accounting is taking place in various parts of the world as a number of national and sub-national governments shift towards accrual accounting for the non-business public sector. This Study identifies, and acknowledges, that a wide variety of views exist about whether, when and how certain revenue should be recognized and reported. It is intended that this Study will contribute to the debate about these issues. The Study seeks to compare the differing views expressed with the user needs identified in Study 1 and Study 2, and to indicate a recommended direction of change necessary to best inform both users of the financial reports and decision makers in the public sector.

The IFAC PSC hopes that this Study will encourage readers, whether or not they are members of the accounting profession, to consider alternative approaches to the definition and recognition of revenues and to contribute to international developments leading to improvements to financial reporting by public sector entities and greater comparability of financial reports both between and within jurisdictions.

Definition and Recognition of Revenues

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CHAPTER 1

INTRODUCTION

Purpose of the Study

.001 This Study examines concepts, principles and issues related to the definition and recognition of revenues in the general purpose financial statements of national governments and other non-business public sector entities. The Study identifies and discusses:

(i) the definition and classification of revenues;
(ii) the particular issues and problems arising from certain types of revenues of governments; and
(iii) the effect of different bases of accounting on the definition and recognition of revenues.

Scope of the Study

.002 The IFAC Public Sector Committee (IFAC PSC) has issued a number of related studies. Consistent with PSC Study 1, "*Financial Reporting by National Governments*" (IFAC, 1991) and PSC Study 2, "*Elements of the Financial Statements of Governments*" (IFAC, 1993), the primary focus of this Study is on the financial statements prepared for national governments and for the entities or units they establish for the delivery of goods and services and the achievement of government objectives. Nevertheless, the matters raised in this Study may be equally applicable to other levels of government (state, provincial and local governments).

Need for the Study

.003 Information on revenues is important in assisting users to assess the financial condition and performance of governments. Comparing revenues with expenses helps users to assess interperiod equity (i.e., whether current revenues are sufficient to cover the costs of programs and services provided in the current period). Information on revenues is also important to the government in making assessments of, for example, the impact of taxation and other revenues on the economy or the need for borrowing in the long-term.

.004 Concepts of revenues developed in the private sector pose some interesting issues when applied to governments. Whilst governments have some revenues similar to business enterprises (e.g., inflows arising from the sale of goods and services, interest, dividends), most of their revenues are non-reciprocal transfers in the form of taxes, levies, duties and fines obtained through the use of sovereign powers. Other non-reciprocal revenues may resemble grants and donations received by non-governmental entities although there may be circumstances (e.g., the annual appropriation process) which create particular issues in government. Additionally, generally accepted accounting practice for grants and donations is not particularly well established.

.005 Governments face distinctive measurement problems in recognizing revenues. There is not yet any international consensus on the appropriate basis for measuring taxation revenues. Furthermore, there may be a considerable time lag between the point at which the transaction which gives rise to the revenue takes place and the point at which the amount can be reliably estimated. For example, there may be a lag between the time sales tax is collected by the vendor and the time it is accounted for by the government. To give another example, there may be a lag between the time a citizen or corporation earns income that is subject to tax and the time at which the amount of that tax is determined.

Context of Previous Studies

.006 This Study is one of a series of studies that examine government financial reporting practices.

.007 PSC Study 1 forms the basis for this series of studies. PSC Study 1 identifies the objectives of the financial reports of national governments and their major units, and examines the degree to which those objectives are met by different bases of accounting and reporting models.

.008 PSC Study 1 concluded that the overriding objective of financial reporting is to communicate reliable information that is relevant to the accountability and decision making needs of users. It also notes that this broad objective encompasses a number of specific goals including: communicating information about compliance with spending mandates; the financing of activities; financial condition; and various aspects of performance. PSC Study 1 also describes alternative accounting bases that could be adopted by governments, ranging from the cash basis to the full accrual basis.

.009 PSC Study 2 considers how the elements of financial statements (e.g., assets, liabilities, revenues, expenses/expenditures and net assets) are defined, and the sets, or subsets, of the elements that would be reported under the different bases of accounting. It also explores the implications of reporting particular elements, or subsets thereof, for the messages communicated by financial statements and the achievement of the objectives identified in Study 1.

.010 PSC Study 8, "*The Government Financial Reporting Entity*" considers how the government reporting entity may be defined for financial reporting purposes and the transactions, events and entities that may be encompassed within whole of government financial reports.

.011 Based on the above Studies, IFAC PSC is now undertaking studies that explore different perspectives and approaches to accounting for and reporting specific elements of government financial statements. This Study on revenues is a companion to Study 5, "*Definition and Recognition of Assets*", Study 6, "*Accounting for and Reporting Liabilities*", and Study 10, "*Definition and Recognition of Expenses/Expenditures*".

.012 Using the framework established in PSC Studies 1 and 2 (in particular, alternative accounting bases), this Study explores the range of revenues arising in the public sector. It identifies similarities to, and differences from, revenues in the private sector and examines the issues for financial reporting which arise from the differences. The Study concentrates on the definition and recognition of revenues under a full accrual basis of accounting. Accounting practice at the cash end of the spectrum is well established and the preparation of cash reports is relatively straightforward. However, there are a number of issues to be debated at the more complex accrual end of the spectrum.

CHAPTER 2

ALTERNATIVE BASES OF ACCOUNTING

.013 The main categories of inflows to governments are:

(i) Revenues derived from exchanges in a manner similar to the private sector. These include revenues from sales of goods or services, dividends, interest and gains arising from the sale of assets.

(ii) Revenues derived from the use of sovereign powers. These include a variety of direct and indirect taxes, duties, fees and fines.

(iii) Other non-reciprocal transfers such as grants or donations from other governments, from supranational authorities or from the private sector. There may be restrictions attaching to these transfers or they may be unrestricted.

(iv) Financing inflows, notably borrowings.

(v) Custodial receipts. These include taxes collected as agent for another government, contributions towards pension and welfare funds, and other receipts collected as agent for another entity.

.014 Determining which inflows are to be included as revenue, and the timing of their recognition, depends in part on the accounting basis adopted. PSC Study 1 describes alternative accounting bases that could be adopted by governments, ranging from the cash basis to the full accrual basis. The Study highlights four points on the continuum that represent bases of accounting that are currently adopted by different governments:

(i) cash;
(ii) modified cash;
(iii) modified accrual; and
(iv) full accrual.

The basis of accounting adopted will influence the presentation, content and disclosure of financial information to be presented by the government.

Cash Basis

.015 The “pure” cash basis of accounting recognizes transactions and other events in the reporting period during which cash relating to the transaction or event has been received or paid.

.016 Financial statements prepared using the cash basis of accounting recognize cash receipts and payments for the period and cash balances as at the reporting date. Accordingly, information disclosed in the financial statements under the cash basis indicates whether the government has spent more or less cash than it collected during the reporting period.

.017 The cash basis of accounting recognizes cash inflows as receipts regardless of source or type. Borrowings and custodial receipts are included as revenues, although they may be identified separately from other sources of revenues. For example, a separate schedule of borrowings is often prepared because of the importance of the government’s level of debt for fiscal and monetary policy purposes. Depending on how the reporting entity is defined, revenues may include transfers from reserves.

.018 Under the cash basis of accounting all inflows, regardless of type, are recognized when cash is received.

Modified Cash Basis

.019 The modified cash basis of accounting recognizes as receipts the same types of inflows as does the cash basis. However, it also includes amounts received in a specified period (e.g., sixty days) after the reporting date that relate to events occurring in the reporting period. These amounts may be set up as receivables or simply be recorded as cash.

.020 Under both the cash and modified cash bases of accounting, receipts may be classified to highlight the major sources or types of cash flows:

"*For example, financing transactions involving loan receipts and disbursements may be classified (or reported) separately from other transactions, capital outlays may be distinguished from current outlays and transfer payments in respect of such matters as unemployment benefits, age or invalid pensions and other social security or community benefit payments may be distinguished from expenditures on operating costs*" (PSC Study 2, paragraph .024).

Modified Accrual Basis

.021 PSC Study 2 anticipates that cash flow information will continue to be provided under an accrual basis but additional information will be provided as well. A modified accrual basis of accounting recognizes financial assets as well as cash inflows. The IASC defines financial assets as follows:

"*A financial assets is any asset that is:*

(a) *cash;*
(b) *a contractual right to receive cash or another financial asset from another enterprise;*
(c) *a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or*
(d) *an equity instrument of another enterprise."* (IAS 32, paragraph 5)

.022 The modified accrual basis generally excludes financing inflows as revenues, although it would include the full proceeds from the sale of non-financial assets as revenues.

.023 Different standard-setters have identified different criteria for the timing of revenue recognition under modified accrual accounting. Canada, for example, recommends that revenues, when measurable, be recognized in the period in which the transactions or events occurred which gave rise to the revenues (PSAR Section 1500, paragraph 81). In the United States, the Governmental Accounting Standards Board (GASB) criteria relate more to the timing of cash flows. According to the GASB, a modified accrual basis requires revenues from taxpayer-assessed taxes to be recognized in the accounting period in which they become susceptible to accrual; that is, when they become both measurable and available to finance expenditures of the fiscal period. "Available" means collectible within the current period or soon enough thereafter (e.g., within sixty days) to be used to pay liabilities of the current period (GASB Statement 22).

.024 Financial statements prepared using the modified accrual basis of accounting focus on reporting net debt (the difference between financial assets and liabilities) and changes therein. The definition of financial assets adopted will influence the concept of net debt that is reported. In some circumstances, the commonly used term "net debt" can be a positive figure.

.025 Whatever concept of net debt is adopted, the financial statements may be constructed to distinguish between "capital" and "revenue" inflows and the impact of those inflows on short-term or long-term indebtedness. Therefore, in moving from a cash-based system to an accrual-based system, it is important to be able to distinguish revenues from other increases in net assets (e.g., where a governmental entity receives an injection of capital from its parent government).

Full Accrual Basis

.026 The full accrual basis of accounting recognizes the effects of transactions and other events in the period during which they occur, regardless of the timing of associated cash receipts. Financial statements prepared using the full accrual basis of accounting recognize all the assets (including physical assets), liabilities, net assets or equity, revenues, and expenses of an entity.

.027 Under a full accrual basis of accounting, revenues are not considered to include financing inflows. Gains or losses on sales of financial and non-financial assets are recognized by netting the proceeds against the net book values of the assets sold.

.028 Because an accrual basis attempts to recognize events in the period in which they occur, it is possible that unrealized gains (e.g., increases in the value of assets, increases caused by growth of livestock or forests) are included amongst revenues. This will depend on whether or not, in a particular jurisdiction, realization is considered to be a criterion for the recognition of revenues. Some recognition issues related to measurability under the full accrual basis of accounting are dealt within paragraphs .095 and .096.

Focus of this Study

.029 The above discussion indicates that accounting practice at the cash end of the spectrum is well established and the preparation of cash reports is relatively straightforward. In most cases, the receipt of cash sends an unequivocal signal that an increase in service potential or future economic benefits has occurred. Whilst there is less need for judgment under the cash basis of accounting, the IFAC PSC believes that the information needs of users would be better met if governments move along the continuum of accounting bases to a full accrual accounting basis, or at least to a modified accrual basis. There are, however, a number of issues to be debated and resolved at the accrual end of the spectrum. The remainder of this Study therefore concentrates on the definition and recognition of revenues under a full accrual basis of accounting. As argued in Study 1, the full accrual basis is not separate from but rather includes the other bases. Consistent with this approach, a more embracing, rather than a narrower, approach to defining revenues will be discussed.

.030 Revenues are considered under two main categories. The first category is exchange revenues which are, in most cases, equivalent to revenues of business enterprises. The second category is non-reciprocal revenues. This category includes revenues from the use of sovereign powers; in particular, taxation receipts which generally form the major part of government revenues. Non-reciprocal revenues received by governments also include grants, donations and similar transfers. For example, national governments may receive aid or grants from other sovereign governments or from supranational authorities. Component entities of a national government may receive transfers from the parent government, and state or provincial governments may receive transfers from a federal government, which, depending on how the obligations attaching to the transfer are specified, may be viewed as exchange revenue, a restricted grant or an unrestricted grant.

CHAPTER 3

DEFINITION OF EXCHANGE REVENUES

.031 Exchange revenues of a government entity are inflows of resources to a government entity that arise from exchange transactions. An exchange transaction occurs when each party to the transaction sacrifices value and receives in return approximately equal value. Another term for "exchange revenue" is "earned revenue" (Statement of Federal Financial Accounting Standards (SFFAS), paragraphs 30 & 33). A government earns exchange revenue when it provides something of value to the public or to another government entity at a price.

IASC Definition of Revenue

032 The International Accounting Standards Committee (IASC) Framework for the Preparation and Presentation of Financial Statements describes revenues as arising in the course of the ordinary activities of an enterprise. Both revenues and gains are included in the IASC Framework definition of *income.*

"*Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants*" (paragraph 70).

.033 International Accounting Standard (IAS) 18 assumes an accrual basis of accounting, and exchange revenues rather than non-reciprocal revenues. IAS 18 applies to:

(i) the sale of goods;
(ii) the rendering of services; and
(iii) the use by others of enterprise assets yielding interest, royalties and dividends.

"*Goods includes goods produced by the enterprise for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale*" (paragraph 3).

"*The rendering of services typically involves the performance by the enterprise of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period*" (paragraph 4).

IAS 18 also states that the use by others of enterprise assets gives rise to revenue in the form of interest, royalties and dividends (paragraph 5).[1]

.034 IAS 18 does not deal with revenue arising from:

(i) lease agreements (IAS 17);
(ii) dividends arising from investments accounted for under the equity method (IAS 28);
(iii) insurance contracts of insurance enterprises;
(iv) changes in the fair value of financial assets and financial liabilities or their disposal (IAS 32);
(v) changes in the value of other current assets;
(vi) construction contracts (IAS 11);

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1 In relation to non-monetary transactions, IAS 18 notes that "*When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue*" (paragraph 12).

(vii) natural increases in herds, and agricultural and forest products; and
(viii) the extraction of mineral ores.

.035 The term “gains” represents items other than revenues which meet the IASC definition of income. Gains may, or may not, arise in the course of the ordinary activities of an enterprise. Gains include, for example, those arising on the revaluation of long-term assets or marketable securities.

.036 The IASC Framework notes that revenues and gains represent increases in economic benefits and does not regard them as constituting separate elements (paragraph 75). Most standard-setters distinguish between revenues earned in the ordinary course of business, and those that arise otherwise. However, the terms used to describe the elements vary and include revenue, gains and income. In the United Kingdom, the Accounting Standards Board (ASB) uses a single element (gains) to cover revenues and gains. Australia and New Zealand also adopt a single element but use the term “revenues” to refer to both revenues and gains. This Study uses the term “revenues” which encompasses both revenues and gains. The IASC takes the same approach but uses the word “income.”

Applicability of International Accounting Standard 18 to Governments

.037 IAS 18 assumes reciprocal transfers in which the reporting entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (in the form of goods, services, or use of assets) to another party in exchange. The existence of exchanges involving a willing buyer and a willing seller helps to establish the fair value of the goods and services provided, as well as the timing.

.038 Reciprocal transfers form the majority of revenues in the for-profit sector and constitute some of the revenues of governments. Inflows to governments which have an exact counterpart in the for-profit sector include those arising from:

- sale of goods;
- rendering of services;
- interest;
- royalties;
- dividends;
- commissions;
- long term contracts; and
- lease agreements.

.039 In some cases, a government will charge a price for goods or services which does not relate to the cost of providing the goods or services or does not relate to the price the recipient is willing to pay. However, it is also possible for private sector companies to offer “loss leaders” and other services at below a fair price. Furthermore, it can be argued that if the government is subsidizing the consumer, it is obtaining some other benefit (in addition to the receipt of cash or entitlements to cash) through meeting its social objectives. The transaction can therefore be classified as an exchange. An alternative view is that the subsidized transaction comprises two parts, one of which is reciprocal (that is, to the extent that value is received in exchange) and the remaining part of which is non-reciprocal (see Australian Accounting Research Foundation (AARF) 1995, Statement of Accounting Concepts (SAC)-4, paragraph 105).

.040 If the government is using its monopoly powers (e.g., charging a fee for the issue of passports or licenses which greatly exceeds the cost) it could be argued that the transaction is better classified as a tax or involuntary transfer. However, extraction of monopoly prices for particular services is not unique to governments. Monopoly fees should therefore be treated as exchange revenue.

.041 Governmental revenues arising from peripheral or incidental transactions (e.g., from the sale of fixed assets) also have counterparts in the private sector. In some cases, such gains are very significant; for example, a gain on the privatization of a government business enterprise. Such revenues should be separately disclosed.

.042 Depending on the measurement model adopted, revenues could also include gains which occur in the absence of transactions. For a number of these items, there are counterparts in the private sector. For example, gains arising from:

- changes in the fair value of financial assets and financial liabilities;
- changes in the value of other assets such as forests and mineral resources; and
- changes in foreign currency exchange rates.

.043 Whilst gains can be classified as revenues under a comprehensive definition of income, it is practice in some jurisdictions to take gains directly to net assets or equity. A number of countries require for-profit entities to produce a statement of total movements in equity as part of the set of general purpose financial reports. In the public sector, the Chartered Institute of Public Finance and Accountancy (CIPFA) "Code of Accounting Practice on Local Authority Accounting in Great Britain" requires a statement of total movements in reserves which brings together all the recognized gains and losses during the period.

.044 Given that financial reporting standards increasingly require accounting for discontinuing operations, national governments should consider similarly accounting for significant changes in activity such as those arising from the privatization of state functions. The accounting issues for exchange revenues, including gains are usually no different from those in the private sector. However, in some circumstances, the distinct nature and characteristics of governmental assets and liabilities may warrant a different accounting treatment. Also, to the extent that governments have significant holdings of certain asset types (e.g., forests or mineral resources) and generally accepted accounting practice (GAAP) for these types of assets in the private sector is underdeveloped, guidance for entities, including governments operating under a full accrual basis, might be required.

.045 Although there are transactions in government which are identical in nature to those in the for-profit sector, much governmental revenue is in the form of taxes, rates, levies, fines and non-reciprocal grants in which the existence of an exchange relationship is tenuous. While it could be argued that a government receives taxation revenues in return for goods and services (e.g., roads, hospitals, education, law enforcement etc.), the citizens who pay for the services are not necessarily the beneficiaries of them. Payment of tax does not of itself entitle a taxpayer to an equivalent value of services or benefits as there is no direct relationship between paying tax and receiving government services or transfers. The remainder of this Study considers the definition and recognition issues for non-reciprocal transfers.

CHAPTER 4

DEFINITION OF NON-RECIPROCAL REVENUES

.046 A non-reciprocal transfer is one in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer. Taxation is the major source of such inflows of economic benefits. Some jurisdictions use the term "non-exchange" transfer to refer to non-reciprocal transfers. For example, GASB defines revenues as follows:

"In governmental funds, increases in financial resources from transactions other than interfund transfers, the issuance of general long-term capital debt, and the sale or capital lease of capital assets. Governmental fund revenues usually result from taxation and other nonexchange transactions or events" (GASB Statement 11, page 99).

.047 In addition to taxation receipts, governments may also receive grants, donations and payments on behalf of other parties. For example, national governments may receive aid or grants from other sovereign governments or from supranational authorities. Component entities of a national government may receive transfers from the parent government which under some circumstances might be viewed as an exchange relationship with the parent government but under other circumstances might still be viewed as non-reciprocal transfers.

Significance of Non-reciprocal Revenues in Governments

.048 In business enterprises, the amount of revenues is an important component in the determination of profit, which is the primary measure of operating performance and which can provide~~s~~ an indication of both efficiency and effectiveness. However, the primary objectives of governments do not include maximization of revenues and profits. Rather, revenues are a means by which governments carry out their objectives of maximizing the welfare of society. Although governments have some revenues which have exact equivalents in the for-profit sector and which can, under a full accrual basis of accounting, be given the same accounting treatment, the majority of governmental revenues are in the form of non-reciprocal transfers. Furthermore, since governments are able to obtain taxation revenues through their sovereign powers to demand payment, the amount of revenues does not provide an indication of their efficiency or effectiveness.

.049 Governments may charge for goods and services provided to other entities or directly to members of the public. However, they may do so at a price which is well below cost in order to meet other economic or social objectives. Because a government has the ability to raise taxes, it can continue in operation even when expenses exceed non-tax revenues.

Revenues from the Use of Sovereign Powers

.050 Governments receive involuntary transfers through the use of their coercive powers. The types of such transfers are extremely wide-ranging, come under a variety of names, and vary from one jurisdiction to another, but may include:

- income tax (collected on a provisional, pay-as-you-earn, terminal or other timing basis);
- fringe benefits tax;
- sales tax;
- value-added tax;
- payroll tax;
- property tax;
- capital gains tax;
- stamp, cheque and credit duties;

- licence tax;
- road-user charges and motor vehicle fees;
- levies; and
- fines.

.051 Taxation is the major category of non-reciprocal, or non-exchange, transfers in governments. Although governments provide goods and services as a result of these transfers, they are not provided directly and are not of approximately equal value to the assets transferred except by coincidence. Governments are not obliged to provide goods and services to particular individuals in return for their involuntary payment. The economic benefit to a government derived from the raising of taxes is its ability to meet its economic and social objectives of providing goods and services to society.

.052 In addition to raising revenues, many governments use tax systems to achieve public policy objectives. The term “tax expenditures” is used to refer to measures such as exemptions, allowances, tax rate reductions, tax credits and tax exempt status because they reduce the tax bills of those who receive them and are therefore analogous to subsidies. Tax expenditures are not revenues but represent tax revenue foregone. The PSC Study 10, “*Definition and Recognition of Expenses/Expenditures*” deals with the issue of tax expenditures on the part of governments.

Grants and Donations

.053 IASC standards provide limited guidance on non-reciprocal transfers, other than IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance.* IAS 20 deals with accounting for government grants by recipients. The definition of government grants is:

“*Government grants are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise....*” (paragraph 3).

.054 The scope of IAS 20 is confined to grants provided by governments in return for compliance with certain conditions. Although IAS 20 is intended to apply to grants between governments and independent third parties, the accounting principles may also be relevant to situations where a department or agency receives a grant from the parent government in order to enable the recipient to carry out specified operating activities.

.055 In addition, governments may be the recipients of unrestricted grants or donations in cash (e.g., a non-repayable loan from another government or supranational authority) or in kind (e.g., donations of heritage assets). Such grants and donations are analogous to those in the non-profit private sector; (e.g., monetary donations, services provided voluntarily or donations of goods in kind). Such transfers cover a wider range of non-reciprocal transfers than merely the governmental grants covered by IAS 20.

.056 This Study uses the term “grants” or “contributions” to refer to non-reciprocal transfers other than those obtained through the use of sovereign powers. Grants are non-reciprocal transfers between one entity and another except where the transfer is a contribution by owners. Grants may take the form of cash, services, transfer of an asset or reduction of an existing liability. Conditions may or may not attach to the grant. In some countries, the term “grant” is associated with a certain type of discretionary receipt and the term “transfers” is therefore used to refer to the broad range of non-reciprocal transfers including grants, shared cost agreements and entitlements.

.057 Grants include savings in outflows of future economic benefits. One example is the forgiveness of liabilities from another government or a supranational authority. Since the forgiveness of debt owed by a national government will not represent a contribution by owners, it should be identified as an item of revenue.

.058 The PSC Study 10, "*Definition and Recognition of Expenses/Expenditures*" examines non-reciprocal transfers where the government is the donor.

Restricted and Unrestricted Revenues

.059 Restrictions are imposed stipulations that specify how resources are to be used and for which the government is accountable to a specific external party. Revenues subject to restrictions may not be able to be used to meet a government's general obligations and finance its operations. It is therefore important to disclose information about those restrictions.

.060 Restrictions may be imposed, for example, when a government is in receipt of a grant from another government. Appropriations of tax revenues by the legislature might also be regarded as imposing restrictions on a government which is accountable to the legislature (and thereby the public at large) for the way the resources are used. However, while accepting that all tax revenues are in some sense restricted, it is possible to confine the term "restrictions" to situations in which there is accountability to a specific external party. From the point of view of component entities of governments which are receiving funds under appropriations, the restrictions arising from appropriations are seen to be externally imposed.

.061 The term "restrictions" does not include reserves created when a government designates a portion of its unrestricted accumulated surplus/deficit to reflect its intention to use those resources for certain purposes. While reserves are formally imposed, governments can change the legislation or resolution and use the resources for another purpose if the need arises. While useful for managing resources, reserves are not restrictions in substance.

.062 Restrictions are imposed in various ways. Agreements made between a government and an external party may specify restrictions on the use of resources. Restrictions may also be stipulated by legislation, either imposed by legislation of another government or embodied in a government's own legislation.

.063 When restrictions are externally imposed, it is clear that the resources are not available except for the specified purposes. The situation is less clear when a government's own legislation imposes restrictions, especially given a government may be able to change its own legislation.

Non-reciprocal Revenues under an Accrual Basis of Accounting

.064 Under an accrual basis of accounting, revenues need to be distinguished from:

(i) taxes and seigniorage;
(ii) contributions from owners; and
(iii) agency payments.

Taxes and Seigniorage

.065 In the for-profit sector, revenues are an important element in performance measurement. The IASC Framework states that income (i.e., revenues and gains) and expenses are directly related to the measurement of profit, which is frequently used as a measure of performance or as the basis for other measures such as return on investment or earnings per share (paragraph 69).

.066 Governmental revenues such as taxes are not an element of performance measurement in the same way. On one hand, taxation receipts could be viewed as a financing source in that they constitute receipts from external providers used to finance activities and are not receipts from the sale of goods and services. They are a means of financing a government's operations rather than a consequence of those operations. In the United States the accounting standard for revenue states:

"*The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.*" (SFFAS No. 7, paragraph 23)

.067 On the other hand, taxation receipts frequently make up the majority of a government's revenues and are generally viewed as an important component in measuring the government's financial results during the period, and in assessing intergenerational equity. For these reasons, there is a general acceptance internationally that collection of taxes should be viewed as part of the operating activities of a government and, therefore, a component of revenue.

.068 If taxes are to be treated as revenues, they need to be distinguished from other financing sources. For example, the Government Finance Officers Association (GFOA), in the explanation of terms used in its publication *Governmental Accounting, Auditing and Financial Reporting (GAAFR)* defines revenues as follows:

"*(1) Increases in the net current assets of a governmental fund type from other than expenditure refunds and residual equity transfers. Also, general long-term debt proceeds and operating transfers in are classified as "other financing sources" rather than as revenues. (2) Increases in the net total assets of a proprietary fund type from other than expense refunds, capital contributions and residual equity transfers. Also, operating transfers in are classified separately from revenues*" (GAAFR 1994, p. 349)[1].

Primarily, non-reciprocal revenues are distinguished from other financing sources, such as borrowing, by the absence of an associated liability.

.069 A further financing source in government can arise through the existence of sovereign powers to directly create money (seigniorage). To the extent that the government uses newly created money to finance its own operations (as opposed to putting the money into general circulation resulting in a liability to holders), the increased cash available to fund governmental activities could be regarded as revenue.

Contributions from Owners

.070 Definitions of revenues or income (see paragraph .031 above) typically exclude contributions by owners which may be defined as follows:

"*"Contributions by owners" means future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that give rise to a financial interest in the net assets of the entity which:*

(a) conveys entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or

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1 Residual equity transfers are "*non-recurring or non-routine transfers of equity between funds (e.g., contribution of enterprise fund or internal service fund capital by the general fund, subsequent return of all or part of such contribution to the general fund and transfers of residual balances of discontinued funds to the general fund or a debt service fund.*" (GAAFR, p. 350). Operating transfers are "*all interfund transfers other than residual equity transfers (e.g., legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended).*"

(b) can be sold, transferred or redeemed"

(AARF, SAC 4, paragraph 144; similar to NZSA, *Statement of Concepts for General Purpose Financial Reporting*, paragraph 7.27)

.071 Some increases in net assets of governments are in the nature of contributions from owners, such as when a department or agency of government receives a capital injection from the parent government. The question then arises as to whether all non-reciprocal transfers made with the intention of "permanently" increasing the capacity to provide service might be viewed as contributions from owners rather than revenues. For example, a government may raise taxes for the purpose of financing construction of infrastructure.

Conceivably, taxpayers could be viewed as the equivalent of "owners" in the private sector on the grounds that it is difficult to identify another party who should be considered "equity" owners in the government as a whole.

.072 In most cases, however, taxes are not related to "capital" or "operating" contributions. The allocation of taxes to capital or operating uses is at the discretion of the government, not the taxpayer. Whether taxes increase the operating capability of government depends on how it uses the funds and the policies it adopts in recovering the costs of operation.

.073 Furthermore, taxpayers do not have a financial interest that can be sold, transferred or redeemed. A particular taxpayer may or may not directly benefit from new infrastructure or other increase in net assets. Under the definition in paragraph .070, therefore, ownership in government would be confined to such situations as a national government which is entitled to distributions from its agents (e.g., department or state enterprise) and would not include the public at large. Thus taxation receipts, whether used for capital or operating purposes, would be classified as revenues.

Agency Payments

.074 Revenues include only the gross inflows of economic benefits received and receivable by the enterprise on its own account. IAS 18 states that amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value-added taxes are not economic benefits which flow to the enterprise and do not result in increases in equity. IAS 18 therefore excludes them from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits do not result in increases in equity and are therefore not revenue. Instead, revenue is the amount of commission (paragraph 8).

.075 Governments often receive or collect resources which are transferred to another recipient, governmental or otherwise. Accounting practice for such transfers varies considerably; with some recipient governments not recording the receipt or disbursement at all, since they net out to zero, while others record them in the financial statements as a flow-through. Whilst taxation might be the primary example of such agency relationship, there might also be other agency relationships such as where a property service agency collects rents on behalf of the government.

.076 The GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance* deals with the issue of "pass-through" grants. It states that pass-through grants should be reported as revenues and expenditures or expenses in a governmental, proprietary, or trust fund. In those rare cases where a recipient government serves only as a cash conduit, the grant should be reported in an agency fund. A recipient government serves only as a cash conduit if it merely transmits grantor-supplied monies without performing administrative functions or having direct financial involvement in the program (GASB, 1994, paragraph 5).

.077 When a government acts merely as a conduit, the revenues and grants have similar characteristics to trust funds. It could be argued that in such cases amounts should not be recorded as revenues since they are not the government's funds but simply flow through to the true beneficiary.

.078 In addition to agency payments from and to specific parties, governments collect taxes which are not used in the government's own operations but are redistributed; for example, in the form of welfare benefits. Adopting the position taken in IAS 18 (see paragraph .074 above), it is possible to argue that these are not revenues of government and that it is only the taxes used to administer the system (i.e., the "commission"), not the resources redistributed, which should be treated as revenue. However, redistribution is itself a major part of the operating activities of governments. All tax inflows should therefore be treated as revenues at the whole of government level. However, where the one government collects taxes on an agency basis for another government, those taxes should not be recognized by the government acting as agent. This would only apply where it is legally unambiguous that such an agency relationship exists.

.079 For the government agency responsible for collecting taxes, it is appropriate that only the amount it receives under appropriation for administering the taxation system is treated as revenue, not the tax inflows themselves. For the government as a whole, however, omitting some tax inflows because they are redistributed would give a misleading picture of the size of governmental activity.

CHAPTER 5

RECOGNITION OF REVENUES

.080 Once items have been defined as revenues, the major issue is determining when they are to be recognized. Citizens and legislative bodies regard the difference between revenues and expenses and/or expenditures as an important aspect of financial performance. Many believe that interperiod equity is an important principle in governmental accounting. The concern about interperiod equity is reflected in balanced budget requirements which exist at the national level for some governments and which are particularly common at sub-national levels. Whilst non-financial information, together with costs, provides measures or indicators of performance itself, the difference between revenues and expenses provides some indication as to whether interperiod equity has been maintained. In such circumstances, the timing of the recognition of revenues becomes particularly important.

.081 Criteria for recognizing revenues under a cash basis of accounting are well understood (see Chapter 2). However, because governments have considerable ability to influence the timing of their cash inflows, an accrual basis of accounting provides more useful information.

.082 GASB 11, *Measurement Focus and Basis of Accounting - Governmental Fund Operating Statements* requires that all government revenues be accounted for on full accrual basis based on interperiod equity. GASB 11 states that an accrual basis of accounting generally is necessary to measure interperiod equity because it recognizes the effects of transactions or events when they take place (a specific time period), regardless of when cash is received or paid.

.083 This chapter identifies existing criteria for recognition of revenues under a full accrual basis of accounting. These generally envisage exchange revenues. The chapter then examines the extent to which such criteria can be applied to non-reciprocal revenues.

General Recognition Criteria

.084 In general, the criteria for recognition of revenues in the operating statement are:

(i) it is *probable* that the inflow (or other enhancement or saving in outflows of future economic benefits) has occurred; and

(ii) the inflow (or other enhancement or saving in outflows of future economic benefits) can be *measured reliably*.

These criteria are adopted in the IASC Framework (paragraph 83) and a number of conceptual frameworks internationally.

Probability

.085 The term “probable” can be taken to mean that the chance of the inflow (or other enhancement or saving in outflows of future economic benefits) is more likely than less likely. Because the probability will vary, assessments of the degree of certainty attaching to the revenues in any particular circumstance should be made on the basis of available evidence.

Measurability

.086 Whilst revenue items are often capable of measurement with a high degree of reliability, in some cases they may be the subject of estimates. In such cases, probable revenues would qualify for recognition only if they could be measured reliably.

.087 What constitutes reliable measurement depends in part on the measurement model adopted and its underlying concepts of capital and capital maintenance. For example, an increase in the value of assets held meets the definition of revenues and could be measured by reference to market selling prices. Under a historic cost model, however, the occurrence of a transaction is normally required for the enhancement in an asset's value to be recognized as revenue. In contrast, under an exit price model, increased market selling prices of assets held by the entity would be recognized as prices change.

.088 Further discussion of measurement models is beyond the scope of this Study. The PSC intends to deal with measurement as a separate project in relation to all the elements of financial statements using an accrual basis of accounting.

Specific Recognition Criteria

.089 A number of frameworks impose further requirements that the recognition criteria need to be applied prudently, especially in respect of revenues. For example, Financial Accounting Standards Board (FASB) *Statement of Financial Accounting Concepts (SFAC) No. 5* states that:

"*Moreover, as a reaction to uncertainty, more stringent requirements historically have been imposed for recognizing revenues and gains than for recognizing expenses and losses, and those conservative reactions influence the guidance for applying the recognition criteria to components of earnings*" (paragraph 81).

.090 The FASB SFAC 5 also states that recognition of revenues and gains involves consideration of two factors:

"*(a)* *Realized or realizable.....Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash.*

(b) *Earned.....An entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.*" (paragraph 83)

.091 In a similar vein, Chapter 4 of the UK ASB *Discussion Draft Statement of Principles: The Recognition of Items in Financial Statements* comments that "*In dealing with uncertainty, prudence requires more persuasive evidence (of both occurrence and amount) for the recognition of items that result in an increase in equity than for the recognition of items that do not*" (1992, paragraph 24). The ASB states that gains must have been earned, i.e., they must not belong to a future period and there must not be any material transaction, contract or other event that must occur before the change in the assets or liabilities of the entity inherent in the gain will have occurred (1992, paragraph 55(a)).

Applicability of General Criteria to Non-reciprocal Revenues

.092 GASB 11, *Measurement and Basis of Accounting - Governmental Fund Operating Statements* acknowledges that governments raise revenues from both exchange and non-exchange transactions. For the majority of exchange transactions undertaken by governments, the circumstances are similar to those found in the private sector and IASC standards can therefore be applied. The extent to which the recognition criteria can be applied to non-reciprocal revenues is discussed below.

Probability

.093 When an entity has received cash or has an explicit claim against an external party, little or no uncertainty is involved. However, the absence of an exchange transaction (e.g., a grant has been approved or promised but not yet received) will often raise doubts about whether the requisite degree of certainty has been attained.

.094 As with other financial elements, resolution of uncertainty to an acceptable level is the major factor influencing recognition. The right to receive cash arises from the sale of goods or services in the case of business revenue. For governmental tax revenues the right to receive cash is dependent on the type of tax revenue and the legislation governing its collection. The legislation governing collection, together with its administration, appear to be the biggest influences on the level of uncertainty and therefore on the recognition of tax revenue.

Measurability

.095 Whilst it may be probable that a government is entitled to revenue at the time a taxpayer earns income subject to taxation or, in the case of sales taxes, when a sale is made, it may not be possible to measure the amount of the revenue until some later point — for example, at the end of the income year, when tax returns are filed or when tax is assessed. Similarly, an offence giving rise to a fine may have been detected but the amount of the fine may not have yet been determined or demands for payment may not have yet been made.

.096 The sophistication of the technology and accounting systems available will influence the point at which tax revenues can be reliably measured; for example, it may not be possible to measure the revenue at the point when the liability to the government is incurred and the payment-due date might have to be used instead.

Applicability of Specific Criteria to Non-reciprocal Revenues

.097 Although the earnings criterion can be applied to exchange revenues, there are problems in applying a notion of "earning" to non-reciprocal revenues.

.098 In the case of taxes, there are a number of possible points at which it could be argued the revenue is "earned", that is, that a debt to the government first arises. For example, in the case of income tax, it could be:

- when the taxpayer earns the taxable income;
- at the end of the income year;
- when the tax returns are filed;
- when tax is assessed; or
- when a tax liability is recognized by the taxpayer.

Similarly, in the case of sales taxes, a government could recognize revenue when the sale is made or when the tax is payable.

.099 Some governments require the payment of provisional taxes; that is, payment of taxes in anticipation of earnings in future periods but which are payable in the current period. An earnings-based approach might argue that such taxes had not been "earned". On the other hand, since the government has a legally enforceable right to receive cash such taxes are probably best treated as revenues of the current period. Also, the amount can be reliably measured because provisional taxes charged will probably be challenged by the taxpaying individual or legal entity if the provisional tax is too high compared with their expected income level.

.100 Whilst GASB 11 suggests that revenue from exchange transactions is to be recognized as soon as it is earned, it applies different criteria to the recognition of taxation revenue:

- the underlying transaction or event has taken place; and
- the government has demanded the taxes from the taxpayer by establishing a due date on or before the end of the period. However, taxpayer-assessed taxes with a due date within two months after the end of the period to allow for "administrative lead time" should be considered as having been demanded as of the end of the period.

.101 The Australian Accounting Standards Board and Public Sector Accounting Standards Board do not support the earnings-based approach and identify problems which may arise if it were applied to non-reciprocal revenues (SAC 4, paragraphs A83 - A88). If it is considered that revenues should be recognized when "earned", it is possible to argue that contributions should be recognized as revenues as goods and services are provided to beneficiaries. For example, where contributions are used to acquire depreciable assets it might be appropriate to recognize the contributions as revenues when depreciation of the assets is charged.

.102 However, recognition of contributions when expenses are incurred may give rise to problems. Where there is not a clear relationship between the contribution and the provision of goods and services, allocation of the contributions to the goods and services could be considered arbitrary. Furthermore, where the contribution is provided for the acquisition of a non-depreciable asset, an "earnings" approach might result in the recognition of a perpetual liability. The decision of an entity to dispose of a grant-funded depreciable asset would accelerate the recognition of revenues vis-à-vis the retention and subsequent depreciation of the asset. Some argue, therefore, that this may allow too much managerial flexibility in reporting results and detract from comparability between entities.

.103 On the other hand, when there is a relationship between the contributions and the provision of goods and services (under a modified accrual basis of accounting), or acquisition of goods and services (under a modified accrual basis of accounting), relating the timing of revenue recognition to the related expense/expenditure may be considered a better measure of operating results. However, as discussed under recognition of restricted revenues in paragraphs .110 to .115 below, there is not always consensus on when such a relationship exists.

.104 When problems arise in applying a strict earnings-based approach, it may be simpler to recognize contributions when the reporting entity receives cash or a right to cash rather than when earned. At the point at which the entity receives the cash, it gains control over the assets, thereby meeting the definition of revenue as an increase in net assets.

Approaches to Recognizing Non-reciprocal Revenues

.105 Taking the above criteria into consideration, it is possible to suggest how particular forms of non-reciprocal revenue might be recognized. Whilst the general criteria of probability and measurability can be applied to non-reciprocal revenues (the problems identified in paragraphs .093 to .096 above tend to be practical rather than conceptual), the specific criteria used for exchange revenues cannot be readily applied. For example, criteria in IAS 18 relate to the identification of the point at which an exchange takes place, such as the transfer of significant risks and rewards of ownership in the sale of goods, the stage of completion in the rendering of services, or the earning of interest. Such criteria have limited relevance where there is not a reciprocal exchange. Some possible recognition points for different types of non-reciprocal revenues are identified below.

Tax Revenues

.106 Combining the probability and measurability criteria, it is possible to specify points at which tax revenues, in any particular government under a full accrual basis, are first able to be recognized. For example, the New Zealand Government, which uses a full accrual basis of accounting, identifies the following revenue recognition points for various types of taxes.

REVENUE TYPE	REVENUE RECOGNITION POINT
Source deductions (PAYE)	When an individual earns income that is subject to PAYE
Residents' withholding tax	When an individual is paid interest or dividends subject to deduction at source
Fringe benefit tax (FBT)	When benefits are provided that give rise to FBT
Provisional tax	Payment due date
Terminal tax	Assessment filed date
Goods and services tax (GST)	When liability to the Crown is incurred
Excise duty	When goods are subject to duty
Road user charges and motor vehicle fees	When payment for the fee charge is made
Stamp, cheque and credit card duties	Assessment filed date
Other indirect taxes	When debt to the Crown arises

.107 In many cases the amount of the revenues and the timing of their recognition will be clear; for example, the amounts are assessed and paid in the same reporting period or periodic instalments have been made and it is only the final installment and potential refunds that have to be estimated. In cases where the amount and timing of recognition is less clear, revenues should be recognized if the amount of revenue in the reporting period can be reliably determined, as already described in paragraph .095.

.108 The reliability of revenue estimation is a matter of professional judgment. It will involve estimation based on such factors as past experience and current financial, economic and environmental factors. The usefulness of financial reports will be enhanced if users are informed (for example, in notes to the financial reports) of the basis on which estimations are made. If adequate systems are put in place for budget preparation, monitoring and resource management, they are also likely to be able to generate sufficiently reliable information for recognition of revenues prior to their actual collection.

.109 In the United States, tax and other non-exchange revenue are recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets (SFFAS No. 7, paragraph 48). The revenue would be recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., can be reasonably estimated). Given limitations of existing information processing systems, there may be difficulties in measuring the amount of taxes due and collectible. In such circumstances, supplementary information is required to partly substitute for an earlier recognition point when the amount cannot be measured reliably.

Grants and Contributions

.110 Unrestricted grants meet recognition criteria as soon as they are received or receivable. Recognition of restricted grants, however, may be more problematic.

.111 Governments receive restricted grants to assist them in carrying out their responsibilities for providing services. That benefit might not actually be obtained until a subsequent period because of the timing of performance of necessary conditions. Since there is an obligation to meet the restrictions imposed, the key issue is the timing of the recognition of the inflows as revenues.

.112 Some possible alternatives for revenue recognition are:

- Matching revenues with expenses/expenditures to which they relate. Revenue recognition does not occur until conditions have been fulfilled. Consistent with the accounting basis adopted, this results in a deferral of revenues as liabilities if the conditions have not been met.

- Recognizing the inflows as revenues when received or receivable, but segregating them on the financial statements as restricted in use.

- Recognizing the inflows as revenues when received or receivable, with disclosure of the restrictions in the notes to the financial statements only. This approach ignores restrictions for revenue recognition purposes.

.113 In assessing the alternatives, it is useful to consider them in the context of different types of restricted-use revenues. For example, some contributions are received under a specific agreement or program and the purpose for which they are received is outlined in the terms of the agreement or related legislation. There is a clear understanding that the funds are to be spent only for very specific purposes. In other cases, the restriction may be related to a broad class of expenses/expenditures such as “growth-related infrastructure”, which still allows the government some discretion in when the resources are used and on which projects. It is restrictive only in the sense that the government does not have the discretion to use the resources for unrelated purposes.

.114 Debate exists on the appropriate timing of the recognition of contributions that are restricted in use. The Australian Public Sector Accounting Standards Board (PSASB) argues that revenue recognition for contributions should be related to when the government obtains control over the contributed assets (AAG 14). For example, when the government can deploy the resources to earn interest revenues for the government, the government controls the assets because it can benefit from them in pursuit of its objectives. The PSASB argue that restrictions on the use of an asset should only influence the timing of revenue recognition if the restrictions affect the government’s capacity to use the asset in pursuing its objectives. Although a government may be expected to use resources to pursue service-delivery objectives, revenue recognition should not be deferred because a liability does not exist unless the government is obliged to sacrifice future economic benefits directly to an external party in return for their contributions. Fiduciary obligations to carry out certain activities and sacrifice economic benefits in the future are not considered to be liabilities because such an approach could be argued to impose an unacceptably broad notion of liabilities.

.115 However, others believe that externally restricted inflows should be recognized as revenues only once the resources have been used for the purpose or purposes specified (under a modified accrual basis of accounting), or when the related expenses are recognized (under a full accrual basis of accounting). It is argued that the government has an obligation to external parties until the resources are used as stipulated, and that this obligation is best reflected by recording the unspent portion as deferred revenue. It is also contended that this approach results in a more appropriate matching of the recognition of expenses/expenditures with the revenues related to them. Under this view, disclosure alone of the limitation on the government’s discretion to use resources other than as specified by the external party is insufficient. This approach has been adopted by some standard-setters, such as in Canada, in relation to both governments and accounting by charities or not-for-profit organizations.

Appropriations

.116 Appropriations are an authorization to expend funds, not revenues of the government as a whole. However, for individual entities of government which receive funds under appropriation, funds used to finance operating activities in the reporting period should be treated as revenue. Revenues for services performed should not be accrued if the legislature has yet to approve an appropriation for that purpose.

.117 The legislation and administrative arrangements surrounding appropriations varies considerably from one jurisdiction to another. In some countries (such as New Zealand) which operate under a full accrual basis and have explicit agreements between the government and its agencies specifying the goods and services to be produced, the funds received under appropriation for the production of outputs may be accounted for as exchange revenue. In other jurisdictions, the funds received under appropriation may be more in the nature of restricted grants. From the point of view of the individual department or agency receiving the funds under appropriation, these restrictions are externally imposed (by the government as a whole or the legislature).

.118 Under a full accrual basis of accounting, appropriations used to increase the resource base of a governmental entity could be classified as contributions by owners where the parent government is viewed as “owner”. Funds received under appropriation for transfer to third parties should be treated as custodial receipts and reported separately from revenues.

.119 In general, unexpended appropriations should not be treated as revenue where they must be returned to the parent government because there is not a legal entitlement to the resources. If agencies are permitted to carry-over unexpended appropriations, or some portion of them, the associated funds may be treated as revenue.

.120 In the United States, appropriations are recognized as used to finance operations when an entity acquires goods and services, or when it acquires benefits and grants that are authorized to be paid by the appropriations. The remaining amount of appropriations enacted into law, but not yet recognized as “appropriations used”, are reflected as “unexpended appropriations” in the equity section of entity’s balance sheet. (SFFAS No.7, paragraphs 71 & 72)

CHAPTER 6

CLASSIFICATION OF REVENUES

.121 There are a number of existing systems for classifying inflows to national governments for purposes of economic analysis and international comparison. Notable among these are the United Nations' System of National Accounts (SNA), the International Monetary Fund's Government Finance Statistics (GFS) and the European System of National and Regional Accounts (ESA).

.122 The SNA framework is used by economic analysts for measuring activity in sectors of the economy, including the public sector. It provides information on government consumption, investment, saving and net lending, all of which are relevant to analysis of fiscal policy and its macroeconomic implications.

.123 The IMF classification system provides internationally comparable figures for its member countries. To date, these measures have been largely cash-based, making no allowance for depreciation or other non-cash items, although revenues and expenditures are separated into current and capital flows. The IMF classification for revenues is contained in Appendix One.

.124 Financial statements for national governments prepared on a full accrual basis provide concise summary information which give an overview of the government's financial position and operating performance. These financial statements complement other fiscal data. Information on revenues, together with information on expenses, is important in order to assess the government's need to borrow in the long-term and hence provides some indication as to whether interperiod equity has been maintained. Classifying revenues into various types helps users to determine how dependent the government is on any particular source and, consequently, the sustainability of its fiscal position. It may be useful to distinguish taxes (fiscal revenues) from non-fiscal revenues in order to assess the government's dependency on this source of revenues and its capacity to obtain further income from this source.

.125 Irrespective of the measurement base adopted, it may be desirable to distinguish financing transactions from other transactions in a statement of cash flows. Receipts may be classified to highlight the major sources or types of cash flows. Statements of cash flows typically classify cash receipts and cash payments by operating, investing and financing activities. The question then arises as to whether taxation receipts should be classified as operating cash flows or financing cash flows.

.126 IAS 7, *Cash Flow Statements* contains the following definitions:

"Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise".

Under these definitions, taxation receipts would be classified as operating cash flows as they are derived from the principal revenue-producing activities of government.

.127 The major types of revenues identified in Chapters 3 and 4 of this Study can be classified as follows:

I EXCHANGE REVENUES AND GAINS

I(a) Realized revenues and gains

- Sales
- Dividends
- Interest
- Royalties
- Gain on asset sales

etc.

I(b) Unrealized gains

- Foreign exchange gains
- Increases in market value of assets
- Increases due to natural accretion e.g., growth of forests, livestock

II REVENUES FROM THE USE OF SOVEREIGN POWERS

(depending on the particular jurisdiction)

- Taxes on income, profits and capital gains
- Sales taxes
- Property taxes
- Payroll taxes
- Poll taxes
- Social security contributions
- Taxes on specific services
- Excises
- Customs and import duties
- Licence and permit fees
- Profits of fiscal monopolies
- Fines
- Seigniorage

III GRANTS AND DONATIONS

III(a) Unrestricted Grants and Donations

- From other levels of government
- From other governments
- From supranational authorities
- From the private sector

III(b) Restricted Grants and Donations

- From other levels of government
- From other governments
- From supranational authorities
- From the private sector

.128 In addition, separate disclosure of discontinuing operations may be useful in helping the reader fully understand government financial reports.

.129 The particular types of revenues, and the names attached to them, will vary across jurisdictions. For example, Appendix 2 provides the classification used by the Government of Italy. Different countries will also vary in the degree of detail they wish to provide and the extent to which general purpose financial reports follow the other classifications, such as those provided in SNA and GFS. Given that economists are increasingly conscious that cash-based fiscal indicators fail to portray the sustainability of government policies, greater convergence between GFS and accrual-based financial statements for national governments can be expected in the future.

CHAPTER 7

CONCLUSIONS

.130 PSC Study 1 concludes that users of governmental financial reports need information to assess the government's overall financial condition, to predict the timing and volume of cash flows and borrowing requirements, and to assess the government's ability to meet its financial obligations, both long and short-term.

.131 To be able to meet those information needs, governments need to report revenues and expenses. The difference between revenues and expenses helps users to assess the government's borrowing needs and to determine whether interperiod equity is being achieved. This Study has examined the definition and recognition of revenues. Another PSC Study examines the definition and recognition of expenses/expenditures, including tax expenditures.

.132 PSC Study 1 describes alternative accounting bases that can be adopted by governments, ranging from the cash basis to the full accrual basis. Accounting practice at the cash end of the spectrum is fairly well established. However, using the cash basis of accounting for non-reciprocal revenues does have some problems. Governments may choose deliberately to smooth income by stipulation of the dates for revenues to be received. Given also the widespread use of measures to obtain payment of tax in advance of assessment, there can be major variation in revenues reported depending on the policy adopted. Yet timing differences have vital effects on the results that demonstrate compliance with budget limits and authorizations and in facilitating the achievement of interperiod equity.

.133 For these reasons, the IFAC PSC believes that the information needs of users would be better met if governments move along the continuum of accounting bases to a full accrual accounting basis or at least to a modified accrual basis. This Study has therefore concentrated on the definition and recognition of revenues under a full accrual basis of accounting. However, guidance on accounting for non-reciprocal revenues on a full accrual basis is not well developed and may depend significantly on legislative, administrative and accounting arrangements in the particular jurisdiction.

.134 Governments receive many types of revenues. The major distinction is between exchange revenues, similar to revenues in the for-profit sector, and non-reciprocal revenues of which tax revenues form the major part. Exchange revenues can be recognized when earned, in a similar manner to for-profit entities. The existence of exchanges both identifies the revenue recognition point and provides a measure of the revenue. However, there are problems in deciding when a non-reciprocal revenue is both probable and measurable. If the principles adopted are that:

(i) the government has an item of revenue at the point that it has the right to receive cash; and
(ii) the revenue item can be recognized when measurable,

then it is possible, in any particular jurisdiction, to identify revenue recognition points depending on the type of revenue and the legislation governing collection.

.135 While moving along the spectrum to an accrual basis of accounting better meets the information needs of users, it will give rise to more complex measurement issues. These will be the subject of a future Study which brings together all the elements of financial statements.

APPENDIX 1

IMF Classification of Government Revenues and Grants

I.	**TOTAL REVENUE AND GRANTS (II + VII)**
II.	**TOTAL REVENUE (III + VI)**
III.	**CURRENT REVENUE (IV + V)**

IV.	**TAX REVENUE**

1.	**Taxes on income, profits, and capital gains**
1.1.	Individual
1.2.	Corporate
1.3.	Other unallocable taxes on income, profits, and capital gains
2.	**Social security contributions**
2.1.	Employees
2.2.	Employers
2.3.	Self-employed or non-employed
2.4.	Other unallocable social security contributions
3.	**Taxes on payroll and work force**
4.	**Taxes on property**
4.1.	Recurrent taxes on immovable property
4.2.	Recurrent taxes on net wealth
4.2.1.	Individual
4.2.2.	Corporate
4.3.	Estate, inheritance, and gift taxes
4.4.	Taxes on financial and capital transactions
4.5.	Non-recurrent taxes on property
4.6.	Other recurrent taxes on property
5.	**Domestic taxes on goods and services**
5.1.	General sales, turnover, or value-added taxes
5.2.	Excises
5.3.	Profits of fiscal monopolies
5.4.	Taxes on specific services
5.5.	Taxes on use of goods or on permission to use goods or to perform activities
5.5.1.	Business and professional licenses
5.5.2.	Motor vehicle taxes
5.5.3.	Other taxes on use of goods or on permission to use goods or to perform activities
5.6.	Other taxes on goods and services

6. **Taxes on international trade and transactions**
6.1. Import duties
6.1.1. Customs duties
6.1.2. Other import charges
6.2. Export duties
6.3. Profits of export or import monopolies
6.4. Exchange profits
6.5. Exchange taxes
6.6. Other taxes on international trade and transactions

7. **Other taxes**
7.1. Poll taxes
7.2. Stamp taxes
7.3. Other taxes not elsewhere classified

V. NON-TAX REVENUE

8. **Entrepreneurial and property income**
8.1. Cash operating surpluses of departmental enterprise sales to the public with a surplus
8.2. From non-financial public enterprises and public financial institutions
8.3. Other property income

9. Administrative fees and charges, non-industrial and incidental sales

10. Fines and forfeits

11. Contributions to government employee pension and welfare funds within government
11.1. Employees
11.2. Employer contributions from other levels of government [1]

12. Other non-tax revenue

VI. CAPITAL REVENUE

13. Sales of fixed capital assets

14. Sales of stocks

15. Sales of land and intangible assets

16. **Capital transfers from non-governmental sources**
16.1. From residents
16.2. From abroad

[1] To be eliminated in consolidation of national government and general government.

VII. GRANTS

17. **From abroad** [2]
17.1. Current
17.2. Capital

18. **From other levels of national government** [1]
18.1. Current
18.2. Capital

19. From supranational authorities to member countries [3]
19.1. Current
19.2. Capital

20. **To supranational authorities from their headquarters**
20.1. Current
20.2. Capital

Memorandum items:

21. Revenue from principal exports

22. Domestic taxes on goods collected at import

23. Revenue from abroad (other than grants)

24. **Cash operating surpluses of departmental enterprise sales to the public with a surplus (same as 8.1)**
24.1. Operating revenue of departmental enterprise sales to the public with a surplus
24.2. Less: Operating expenditure of departmental enterprise sales to the public with a surplus

25. Receipts of government employer contributions to social security from the same level of government (not included above, same as C.12)

26. Taxes collected as agents for other governments (not included above)

27. Taxes collected by other governments as agents (included above)

28. **Grants in kind received (not included above)**
28.1. Grants in kind from abroad [2]
28.1.1 Current
28.1.2. Capital
28.2. Grants in kind from other levels of national government [1]
28.2.1. Current
28.2.2. Capital
28.3. Grants in kind from supranational authorities to member countries [3]
28.3.1. Current
28.3.2. Capital
28.4. Grants in kind to supranational authorities from their headquarters
28.4.1. Current
28.4.2. Capital

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[2] Other than from supranational authorities to member countries.

[3] To be eliminated in consolidation of general government

29. **Transfers in kind from non-governmental sources (not included above**)
29.1. From residents
29.1.1. Current
28.1.2. Capital
29.2. From abroad
29.2.1. Current
29.2.2. Capital

30. **Total grants received in cash and in kind (VII + 28)**
30.1. Total grants from abroad (17 + 28.1) [2]
30.1.1. Current
30.1.2. Capital
30.2. Total grants from other levels of national government (18 + 28.2) [1]
30.2.1. Current
30.2.2. Capital
30.3. Total grants from supranational authorities to member countries (19 + 28.3) [3]
30.3.1. Current
30.3.2. Capital
30.4. Total grants to supranational authorities from their headquarters (20 + 28.4)
30.4.1. Current
30.4.2. Capital

31. Total revenue, grants received in cash and grants received in kind (1 + 28)

APPENDIX 2

Italy's Classification of Revenues

Heading I - Tax Revenues	
Category I	Property tax and income tax
Category II	Turnover taxes and duties
Category III	Taxes on production and consumption and customs duties
Category IV	Monopolies
Category V	State lottery, lotteries and other competitions
Heading II - Extratax Revenues	
Category VI	Special proceeds
Category VII	Proceeds from minor public services
Category VIII	Proceeds from goods of the national government
Category IX	Net products of autonomous agencies and operating profits
Category X	Interests on advances and credits of the Treasury
Category XI	Recoveries, refunds and contributions
Category XII	Items compensated in the expenditure
Heading III - Alienation and Amortization of Assets and Collection of Credits	
Category XIII	Selling of goods and redeeming of rents
Category XIV	Amortization of assets
Category XV	Refunds of advances and credits of the Treasury
Heading IV - Creating Loans	
Creating Loans	
Total Heading IV	
Overall Total	

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