IGFRS 3 - Revenue from government exchange transactions

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Contents

IGFRS

Government Accounting in India follows cash basis of accounting. Government Accounting Standards Advisory Board (GASAB) constituted by Comptroller and Auditor General of India, with the support of Government of India, is working on transition from cash to accrual basis of accounting in Union and States. As per constitutional provisions, any change in basis of accounting (from cash to accrual) would essentially be based on a decision of the President of India on the advice of Comptroller and Auditor General of India. However, there is a need felt for an accounting framework and accounting Standards on accrual basis to facilitate pilot studies and research efforts on migration to accrual accounting at Union and State level. To facilitate such pilot studies and also for scale up of activities, GASAB decided to develop accounting Standards on accrual basis alongside cash basis Standards. The accrual basis Standards are issued under the title ***'Indian Government Financial Reporting Standards (IGFRS)'.*** These Standards will initially be recommendatory for the pilot studies on accrual accounting and will become mandatory, with effect from the date of notification, by Government of India.

Bases for Conclusion

Revenue is one of the key constituents of the financial performance of an entity. The government receives revenue from exchange (rendering of goods & services) and non-exchange (taxes, transfers and fines) transactions. The purpose of the standard is to provide guidance on accounting treatment, principles of recognition and measurement of revenue arising from exchange transactions.

The standard has drawn guidance mainly from *International Public Sector Accounting Standards (IPSAS) 9: Revenue from Exchange Transaction*. It also sought guidance from Standards and Guidelines pronounced by other National Boards and international best practices besides inviting comments of stakeholders.

The Indian Government Financial Reporting Standard (IGFRS) 3 on 'Revenue from government Transactions' was initiated in July 2008. The Exposure Draft(ED) was circulated for invitation to comments from stakeholders with approval of GASAB in November 2008. While the ED sought responses of stakeholders on any of the paragraphs or accounting treatment proposed, stakeholders were specifically requested to respond to the following distinct items where the standard deviates from IPSAS:

a) The Exposure Draft (ED) used the term 'approximately comparable value' to determine revenue from exchange transactions instead of 'approximately equal value'. Since this deviation was supported by most stakeholders, the term 'approximately comparable value has been used in the standard.

b) The ED used interest recognition on simple time proportion basis instead of time proportion basis taking into account the effective yield method. Since this deviation was supported by most stakeholders, the interest recognition on simple time proportion basis has been used in the standard.

c) The ED required that all interest/dividend be recognised as revenue unless they clearly represent a recovery of part from the cost of transaction/investment made instead of allocating interest/dividend received between pre-acquisition and post-acquisition periods with only the latter being treated as revenue and the former a reduction from the cost of the transaction/investment made. Most stakeholders supported this deviation.

d) On specific suggestions of a few stakeholders, implementation guidelines have been included as an Appendix to the IGFRS. However, they are not part of the IGFRS.

Objective

1. The primary activities of government encompass sovereign functions like providing security, developing infrastructure and implementing social welfare programmes. To help discharge its functions, the government essentially realises its revenue from direct and indirect taxes, duties, fines, grants and donations which are non-exchange transaction. Governments also realises revenue from rendering services, sale of goods or use of its assets by others which are exchange transactions This Standard lays down the principles to be followed for recognition and measurement of revenue from exchange transactions by government entities under accrual basis of accounting, wherein transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid).

2. Revenue should be accounted for only when it is earned and it has become reasonably certain that the revenue will be realised. This signifies that revenue should be recognised only when the services are rendered or the sale is effected. Thus, in order to recognise revenue, actual receipt of cash is not necessary.

3. This Standard is applicable to government entities at Union, States, Union Territories with legislature and also their sub-entities where these entities are treated as reporting entities for the purpose of financial statements.

4. The primary issue in accounting for revenue is determining when to recognize revenue. Revenue is recognised only when it is probable that future economic benefits or service potential will flow to the government entity and these benefits can be measured reliably. The Standard identifies the circumstances in which these criteria will be met and, therefore revenue will be recognized. It also provides implementation guidelines on the application of these criteria as appendix to this IGFRS.

5. The Standard is envisaged to provide guidance to the pilot studies and eventual development of a common reporting framework under accrual basis for Union and the States. The IGFRS could be revised by GASAB based on pilot studies.

Scope

6. A government entity which prepares and presents financial statements under accrual basis accounting should apply this Standard in accounting for revenue arising from the following exchange transactions and events:

   a. The rendering of services

   b. The sale of goods

   c. The use by others of entity assets yielding interest, royalties, dividends and fees

7. This Standard does not apply to Public Sector Undertakings (PSUs) like Indian Oil Corporation, BHEL etc. PSUs are required to comply with Accounting Standards issued by the Institute of Chartered Accountants of India and notified by Government of India as per Section 201 A (i) of Companies Act 1956.

8. This Standard does not deal with revenues specifically dealt with by other Indian Government Financial Reporting Standards, including:

a. Gains from sale of property, plant and equipment (IGFRS 2);

b. Lease agreements (IPSAS 13 till formulation of specific IGFRS);

c. Revenue due to natural increases in herds, and agricultural and forest products (IPSAS 27 till formulation of specific IGFRS);

d. Revenue from extraction of mineral ores (Accounting Standard 9 issued by the Institute of Chartered Accountants of India);

e. Revenue from services rendered or goods sold at no charge, nominal charge, or less than comparable will not be recognised under this standard.

Definitions

9. The following terms are used in this Standard with the meanings specified as under:

a. **Exchange transactions** are transactions in which one government entity receives goods or services, or has liabilities extinguished and directly gives approximately comparable value (primarily in the form of cash, goods services or use of assets) to another entity in exchange.

b. **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

c. **Non-exchange transactions** are transactions that are not exchange transactions. In a non-exchange transaction, government entity either receives value from another entity without directly giving approximately comparable value in exchange, or gives value to another entity without directly receiving approximately comparable value in exchange.

d. **Revenue** is the gross inflow of cash, receivables or other considerations arising in the course of ordinary activities of a government entity from the rendering of services, sale of goods and from the use by others of the entity's resources yielding interest, royalties, dividend and fees.

e. **Comparable value** is the value which at least covers the cost of providing goods and services, failing which the replacement cost for the goods or services provided can be taken.

Revenue Recognition

10. Revenue includes only the gross inflows of economic benefits or service potential received and receivable by the government entity on its own account. Amounts collected as agent of the government or another government entity or on behalf of third parties e.g. the collection of electricity payments or telephone bills by the post office on behalf of entities providing those services are not economic benefits or service potential which flow to the entity and do not result in increase in assets or decrease in liabilities. Therefore, they are excluded from revenue. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of any commission received or receivable for the collection or handling of the gross flows.

11. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the government entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognized.

12. Financing inflows, notably borrowings, do not meet the definition of revenue. Financing inflows are taken directly to the statement of financial position and added to the balances of assets and liabilities.

Measurement of Revenue

13. The amount of revenue arising on a transaction is usually determined by the agreement between the government entity and the purchaser or user of the goods, services or assets. It is measured at the value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the government entity.

Identification of the Transaction

14. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when price of a product includes an identifiable amount for subsequent servicing, that amount is deferred, and recognised as revenue over the period during which service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods, and at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

Rendering of Services

15. The rendering of services typically involves performance by the government entity, of an agreed task over an agreed period of time. The services may be rendered within a single period or extend over more than one period. Examples of services rendered by governments for which revenue is typically received in exchange may include the provision of housing, management of water facilities, police protection on request from the organizers of events, management of toll roads.

16. When the outcome of a transaction involving rendering of services can be estimated reliably, revenue associated with the transaction should be recognized with reference to the stage of completion of the transaction at the reporting date.

17. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

a. The amount of revenue can be measured reliably;

b. It is probable that the economic benefits or service potential associated with the transaction will flow to the government entity;

c. The stage of completion of the transaction at the reporting date can be measured reliably; and

d. The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

18. A government entity is generally able to make reliable estimates after it has entered into agreement for the transaction with the other parties as under:

a. Each party's enforceable rights regarding the service to be provided and received;

b. The consideration to be exchanged; and

c. The manner and terms of settlement.

19. The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognized in the reporting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period.

20. The stage of completion of a transaction may be determined by a variety of methods. The ggovernment entity may use the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:

a. Surveys of work performed;

b. Services performed to date as a percentage of total services to be performed;

21. For practical purposes, when services are performed by an indeterminate number of acts over a specified time frame, revenue is recognized on a straight line basis over the specified time frame unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

22. During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the government entity will recover the transaction costs incurred. Therefore, revenue is recognized only to the extent of costs incurred that are expected to be recoverable.

23. When the outcome of a transaction cannot be estimated reliably and it is probable that the costs incurred will not be recovered, revenue is not recognized and the costs incurred are recognized as an expense.

Sale of Goods

24. Goods include goods produced by the government entity for the purpose of sale, such as publications, and goods purchased for resale, such as merchandise or land and other property held for resale.

25. Revenue from the sale of goods should be recognized by the government entity when all the following conditions have been satisfied:

a. The entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;

b. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

c. The amount of revenue can be measured reliably;

d. It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and

e. The costs incurred or to be incurred in respect of the transaction can be measured reliably.

26. The assessment of when the government entity has transferred the significant risks and rewards of ownership to the purchaser requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the purchaser. This is the case for most sales. However, in certain other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.

27. If the government entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognized. A government entity may retain a significant risk of ownership in a number of ways. Some examples are:

a. When the government entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;

b. When the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the purchaser from its sale of the goods (for example, where a government publishing operation distributes educational material to schools on a sale or return basis);

c. When the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

d. When the purchaser has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

28. If government entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognized. Revenue in such cases is recognized at the time of sale provided the seller can reliably estimate future returns.

Interest, Royalties, Dividends and Fees

29. The use by others of government entity's assets gives rise to revenue in the form of:

a. Interest – charges for the use of cash or cash equivalents or amounts due to the entity;

b. Royalties – charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and

c. Dividends or equivalents – distributions of surpluses to holders of equity in proportion to their holdings of a particular class of capital.

d. Fees – charges for the use of assets e.g. License fee for use of roads.

30. Revenue arising from the use of government entity's assets by others yielding interest, royalties and dividends should be recognized using the accounting treatments set out in the following paragraph when:

a. It is probable that the economic benefits or service potential associated with the transaction will flow to the government entity; and

b. The amount of the revenue can be measured reliably.

31. Revenue should be recognized using the following accounting treatments:

a. Interest should be recognized on a time proportion basis;

b. Royalties should be recognized as they are earned in accordance with the substance of the relevant agreement; and

c. Dividends or their equivalents should be recognized when the government entity's right to receive payment is established.

d. Fees should be recognized as and when they are earned in accordance with the substance of the agreement or on time proportion basis.

Disclosure

32. A government entity should disclose

a. The accounting policies adopted for the recognition of revenue including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

b. The rate of interest announced by the RBI for government securities used for discounting of future cash flows;

c. The amount of each significant category of revenue recognized during the period including revenue arising from:

i. The rendering of services;

ii. The sale of goods;

iii. Interest;

iv. Royalties;

v. Dividends or their equivalents; and

vi. Fees

Reporting Currency

33. The reporting currency used to measure revenue in the financial statements is Indian Rupees (INR). All transactions of the government entity taking place in other countries shall be passed on monthly by the Indian Embassies / Missions to India and brought to account finally in the accounts after they have been converted into rupees at a rate determined for such transactions by the Reserve Bank of India.

Effective Date

34. This Indian Government Financial Reporting Standard shall be recommendatory in nature with effect from the date of approval by GASAB. It shall be mandatory for the financial reports covering periods subsequent to the date of notification by Government of India.

Appendix-I

Implementation guidelines

The appendix is illustrative only and does not form part of the Standards. The purpose of the appendix is to illustrate the implementation guidelines and the application of the Standards to assist in clarifying their meaning in a number of situations. The examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors which might influence the recognition of revenue. The examples do not modify or override the Standards.

Revenue from Exchange Transactions is derived from:

a. Sale of goods to other government entities or third parties;

b. Rendering of services to other government entities or third parties;

c. The use by others of government entity's assets yielding interest, royalty, dividends and fees.

Sale of goods to other government entities or third parties

1. Revenue is recognised only when the purchaser takes title (it is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery),

Installation and Inspection

2. Revenue is recognised when the purchaser accepts delivery, and installation and inspections are complete except when:

a. The installation is simple in nature;

b. The inspection is performed only for the purpose of final determination of contract prices;

c. In case of possibility of return of goods, revenue is recognised only when the time period for rejection has lapsed

Recognition of Revenue when payment is made in series of installment

3. Revenue from such sale is recognised when the goods are delivered or ready for delivery to the purchaser.

Recognition of revenue when payment (or partial payment) is received in advance of delivery for goods not presently held in Inventory; (Goods still to be manufactured)

4. Revenue is recognized only when goods are delivered to the purchaser.

Sale and repurchase agreements under which the entity concurrently agrees to repurchase the same goods at a later date, or when the government entity has a Call option to repurchase, or the purchaser has a Put Option requiring repurchase by the government entity of the goods

5. The terms of the agreement need to be analyzed to ascertain whether, in substance, the government entity has transferred the risks and rewards of ownership to the purchaser, and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

Subscriptions to Publications and Similar Items

6. When the items involved are of similar value in each time period, revenue is recognized on a straight line basis over the period in which the items are dispatched. When the items vary in value from period to period, revenue is recognized on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Real Estate Sales

7. Revenue is normally recognized when legal title passes to the purchaser. However, in some jurisdictions the equitable interest in a property may vest in the purchaser before legal title passes, and therefore the risks and rewards of ownership are transferred at that stage. In such cases, provided that the government entity has no further substantial acts to complete under the contract, it may be appropriate to recognize revenue. In either case, if the government entity is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognized as the acts are performed.

8. In some cases, real estate may be sold with a degree of continuing involvement by the government entity, such that the risks and rewards of ownership have not been transferred. Examples are (a) sale and repurchase agreements that include put and call options, and (b) agreements whereby the government entity guarantees occupancy of the property for a specified period, or guarantees a return on the purchaser's investment for a specified period. In such cases, the nature and extent of the government entity's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing, or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the government entity, may delay the recognition of revenue.

Rendering of services to other government entities or third parties

Housing

9. Rental income from the provision of housing is recognized as the revenue is earned in accordance with the terms of the tenancy agreement.

Transport

10. Revenue from fares charged to passengers for the provision of transport is recognized as the transport is provided.

Management of Toll Roads

11. Revenue from the management of toll roads is recognized as it is earned, based on the usage of the roads.

Processing of Court Cases

12. Revenue from the processing of court cases can be recognised either by reference to the stage of completion of the processing, or based on the period during which the course are in session.

Management of Facilities, Assets, or Services

13. Revenue from the management of facilities, assets, or services is recognized over the term of the contract as the management services are provided.

Science and Technology Research

14. Revenue received from contracts for undertaking science and technology research is recognized with reference to the stage of completion on individual projects.

Installation Fees

15. Installation fees are recognized as revenue with reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

Servicing Fees Included in the Price of the Product

16. When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement.

Fees earned as services are provided

17. Fees earned as services are provided are recognised as revenue corresponding to the time, as the services are provided.

Admission Fees

18. Revenue from artistic performances and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

Initiation, Entrance, and Membership Fees

19. Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services, it is recognized on the basis that reflects the timing, nature, and value of the benefits provided.

The use by others of government entity's assets yielding interest, royalty, dividends and fees.

20. Fees and royalties paid for the use of government entity's assets (such as trademarks, patents, software, and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

21. In some cases, whether or not a license fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Interest

22. Interest income of government includes interest from Departmental Commercial Undertakings, interest realized on investment of cash balances, interest from public sector and other undertakings, interest from investments in local bodies, interest from co-operative societies etc. Revenue on account of interest will be accrued based on time period irrespective of whether it is received in cash or not.

Dividends

23. Dividends are received from Public Sector Undertakings (PSUs) and from other investments made by the government entity. Dividends declared by the PSUs are accrued as revenue from the date of declaration irrespective of whether they are received in cash or not.

Appendix-II

Statement of Financial Performance for the year ended March 31, 20X2

Rs. thousands

Revenue Heads	Year 20X2	Year 20X1
Revenue from non exchange transactions	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
Total revenue	X	X