



# HM TREASURY

## Financial Reporting Advisory Board Paper

### IAS 18: *Revenue*

<b>Issue:</b>	Applying IAS 18 <i>Revenue</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual.
<b>Impact on guidance:</b>	The proposed text in Annex A relates to the IFRS-based FReM.
<b>IAS/IFRS adaptation?</b>	No – recommendation to adopt IAS 18 in full.
<b>IPSAS compliant?</b>	There is no IPSAS on this topic.
<b>Interpretation for the public sector context?</b>	Yes – the IFRS-based FReM interprets IAS 18 for the public sector context.
<b>Impact on budgetary regime?</b>	No
<b>Alignment with National Accounts?</b>	Yes
<b>Impact on Estimates?</b>	No
<b>Recommendation:</b>	That the Board agree to adopt IAS 18 pending the development of a new international accounting standard on revenue recognition.
<b>Timing:</b>	Not yet known: depends on decision to move to EU-adopted IFRS and the current research work being undertaken by IASB/FASB.

## **DETAIL**

### ***Background***

1. IAS 18 *Revenue* sets out the accounting treatment of revenue arising from certain types of transactions and events and is applicable for periods beginning on or after 1 January 1995. Revenue arises in the course of an entity's ordinary activities and is referred to by a variety of different names including sales, turnover, fees, interest, dividends, royalties and rents. IAS 18 identifies the primary issue as determining when to recognise revenue and sets out the criteria that should be used for determining whether or not revenue should be recognised.

2. In July 2001 the ASB issued a discussion paper, 'Revenue recognition', that made proposals with the aim of establishing a framework within which to address consistently revenue issues arising in different contexts. In December 2002 the IASB and the US Financial Accounting Standards Board (FASB) agreed to combine their separate researches into a joint project to develop a new accounting standard, which will replace IAS 18. The ASB discussion paper will not now proceed to become a UK standard, but will be used to help establish the UK position so that the ASB may work with the IASB/FASB in their development of a new international financial reporting standard. The IASB/FASB have developed tentative concepts for revenue recognition but do not plan to have preliminary views available until the second quarter of 2007.

3. In the meantime, in November 2003, the ASB issued 'Amendment to FRS 5, 'Reporting the substance of transactions': Revenue recognition' (Application Note G). This is intended as an interim step to provide guidance in the UK until a new Standard is developed internationally, and is effective from 23 December 2003. ASB staff are also participating in a European Financial Reporting Advisory Group (EFRAG) working party on this subject. The International Financial Reporting Interpretations Committee also receives frequent requests for guidance on the application of IAS 18. However, so far the Committee has issued only one Interpretation relating to IAS 18, SIC-31 *Revenue – Barter transactions involving advertising services*, effective from 31 December 2001.

#### *The main features of IAS 18*

4. IAS 18 prescribes the accounting treatment for revenue arising from:

- The sale of goods;
- The rendering of services; and
- The use by others of entity assets yielding interest, royalties and dividends.

It *does not* deal with revenue arising from transactions covered by other Standards, such as:

- Construction contracts (IAS 11);
- Lease agreements (IAS 17);
- Dividends from equity-accounted investments (IAS 28);
- Insurance contracts (IFRS 4);

- Property, Plant and Equipment (IAS 16);
- Changes in the fair value of financial assets and liabilities (IAS 39); and
- Changes in the fair value of biological assets relating to agricultural activity (IAS 41).

5. In IAS 18 revenue is defined as the gross inflow of economic benefit during the period arising in the course of the ordinary activities of an entity, when those inflows result in increases in equity, other than increases relating to contributions from equity participants. Revenue includes only inflows of economic benefits that belong to the entity and it, therefore, excludes amounts collected on behalf of and paid or payable to others, such as value added tax or amounts collected on behalf of a principal by the entity as agent. In the latter case, revenue attributable to the entity would be the commission it is entitled to keep rather than the gross receipts it must pay to the principal.

6. Revenue is measured at the fair value of the consideration received or receivable. The consideration is usually cash. If the inflow of cash is significantly deferred, and there is no interest or a below-market rate of interest, the fair value of the consideration is determined by discounting expected future receipts. If dissimilar goods or services are exchanged (as in barter transactions), revenue is the fair value of the goods or services received or, if this is not reliably measurable, the fair value of the goods or services given up.

7. Revenue from the sale of goods is recognised when:

- Significant risks and rewards of ownership are transferred to the buyer;
- The seller has no continuing managerial involvement or control over the goods;
- The amount of revenue can be measured reliably;
- It is probable that economic benefits will flow to the seller; and
- The costs of the transaction (including future costs) can be measured reliably.

8. Revenue from rendering services is recognised by reference to the stage of completion if the following conditions are met:

- The amount of revenue can be measured reliably;
- It is probable that economic benefits will flow to the service provider;
- The stage of completion of the transaction can be measured reliably; and the costs of the transaction (including future costs) can be measured reliably.

If the outcome cannot be measured reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable.

9. Interest revenue is recognised on a time-proportion basis using the effective interest method. Royalties are recognised on an accruals basis in accordance with the substance of the relevant agreement. Dividend revenue is recognised when the shareholder's right to receive the dividends is

established (i.e. dividends receivable are recognised when declared, and no longer at the discretion of entity paying the dividend).

#### *The main features of SIC 31 – Barter Transactions Involving Advertising Services*

10. SIC 31 was issued in May 2001 to deal with particular issues around revenue recognition in the 'dotcom' boom of the late nineties. Entities usually trade for cash or the right to receive cash. Sometimes, however, transactions are undertaken that involve the swapping of goods or services, these are known as barter transactions. The standard gives the examples of oil and milk, where suppliers exchange stock in different locations to meet local demands. IAS 18 does not permit revenue to be recognised in an exchange or barter of similar goods or services, therefore SIC 31 applies to the exchange of 'dissimilar' services; specifically advertising by each party for the other on the internet, on poster sites, on television or radio, published in magazines or journals or through some other medium.

11. IAS 18 requires revenue to be measured at the fair value of the consideration received or receivable. The consensus is that revenue from an exchange involving advertising services cannot be reliably measured by reference to the fair value of the services received. This is because reliable information is not available to the seller to support such measurement. However, a seller can reliably measure revenue at fair value of the advertising service it provides in a barter transaction, by reference to non-barter transactions that meet certain criteria specified in SIC 31.

#### *Comparison with requirements under UK GAAP*

12. Prior to the issue of Application Note G by the ASB in November 2003, IAS 18 has been used widely, together with US GAAP, by UK entities for guidance on revenue recognition. Application Note G sets out the basic principles of revenue recognition and is intended to codify existing best practice. However, there is a change in emphasis as Application Note G guidance is based on an assets and liabilities approach. This means that an entity should measure revenue according to either an increase in assets (such as a debtor) or a decrease in liabilities (for example, the release of a liability initially set up when a customer pays in advance). The application note also includes specific guidance for five types of transaction that give rise to turnover that have been subject to differing interpretations in practice. These are:

- Long-term contractual performance;
- Separation and linking of contractual arrangements;
- Bill and hold arrangements;
- Sales with right of return; and
- The presentation of turnover by principals and agents.

13. Several Urgent Issues Task Force (UITF) Abstracts also deal with, or touch on, issues relating to revenue recognition and the related matter of cost recognition. These include:

- UITF 24, 'Accounting for start-up costs', issued on 22 March 2000;
- UITF 26, 'Barter transactions for advertising', issued on 9 November 2000;

- UITF 28, 'Operating lease incentives', issued on 22 February 2001;
- UITF 34, 'Pre-contract costs', issued on 21 May 2002;
- UITF 36, 'Contracts for sales of capacity', issued on 27 March 2003; and
- UITF 40, 'Revenue recognition and service contracts', issued on 10 March 2005.

14. IAS 18 does not permit the previous UK practice (pre-2005) of recognising dividends receivable on equity shares at the time they are proposed. Instead, as noted in paragraph 9 to this paper, dividends receivable are recognised when declared rather than proposed. From 1<sup>st</sup> January 2005 UK law has been changed to enable the IFRS treatment to be adopted in the UK.

15. The Companies Act 1985 is more restrictive than IAS 18 in terms of profits that may be included in the profit and loss account. Schedule 4 paragraph 12(a) states, "...only profits realised at the balance sheet date shall be included in the profit and loss account". IAS 18 contains no such restriction and, therefore, there could be instances where revenue that represents an unrealised profit might be included in the profit and loss account under IFRS, which provisions of Schedule 4 to the Act would not permit to be included. A practical example of such a difference is the accounting for revaluation gains, such as those on investment properties that are covered by IAS 40. Other examples include movement in the fair value of held-for-trading financial assets under FRS 26 and biological assets under IAS 41.

16. The work being undertaken by the IASB and FASB to develop a new general Standard on revenue recognition involves an accounting model in which a reporting entity would recognise revenue on the basis of changes in assets and liabilities arising from contracts with customers, without consideration of additional criteria, such as earning or realisation. This is more consistent with Application Note G in the UK rather than IAS 18 but in practice would mean little change for those entities already adopting IAS 18 in the public sector.

#### *Impact of IAS 18 on public sector accounts*

17. Entities covered by the requirements of the FReM are already applying UK GAAP (more specifically, Application Note G and UITF Abstract 40) in full and a move to IAS 18 is unlikely to have any practical impact.

18. In the public sector the parliamentary process, as well as accounting standards, determine how income is presented. In public sector accounts income from the following sources is accounted for as financing through the General Fund rather than shown as income:

- Supply;
- Grants and grants-in-aid;
- Grants from the Department of Constitutional Affairs to the National Assembly of Wales;
- Amounts from the National Insurance Fund in respect of welfare benefits;
- The Consolidated Fund in respect of standing services; and

- Advances from the Contingencies Fund.

More details on the arrangements for government departments and NDPBs can be found in the proposed text for the IFRS-based FReM in Annex A to this report.

### ***IAS/IFRS compliance***

19. The proposal is to adopt IAS 18, as interpreted for the public sector context, and await the outcome of IASB/FASB work to develop a new general Standard on revenue recognition.

### ***IPSAS compliance***

20. IPSASB has yet to issue an IPSAS or an exposure draft of a future IPSAS to interpret IAS 18 for the public sector, and the proposals in Annex A to this paper have not, therefore, been benchmarked against international public sector interpretations.

### ***Proposed text for the IFRS-based Government Financial Reporting Manual***

21. See Annex A for the proposed IFRS-based FReM. The text follows that of the current FReM in using the term “income” rather than “revenue”, to avoid any confusion with taxation revenues.

### ***Alignment with National Accounts***

22. In National Accounts some income reduces the level of recorded public expenditure (such as sale of goods or services) whilst some (such as taxes) finance that expenditure. The international manuals detailing how to produce National Accounts differentiate different types of income and, importantly, have clear rules about the point at which income can be said to accrue. These rules are important as they affect both the timing, and the manner in which, a given transaction scores in measures of the public sector deficit, and current balance (which is used to assess performance against the Golden Rule). Unrealised gains are not recognised as income in the framework of National Accounts. Rather the balance sheet shows assets and liabilities at current prices with changes to values due to changes in market prices recognised in the transaction-less ‘other flow’ accounts. As such the concept and measurement of income/revenue in National Accounts is broadly consistent with UKGAAP as it currently stands.

23. If IAS 18 were adopted without interpretation revenue recorded in the financial statements of public sector entities could include unrealised profits from revaluation gains, such as those described in paragraph 15. This would not be consistent with the framework of National Accounts, and unrealised profits would have to be removed when compiling the National Accounts measures of income and expenditure. It is therefore recommended that IAS 18 be interpreted for the public sector context by stating that, in general, only profits realised at the balance sheet date shall be included in the profit and loss account. The treatment of unrealised profits in other Standards, such as those described in paragraph 15 will depend on their interpretation or adaptation for the public sector context.

### ***Impact on the budgetary regime***

24. The budgeting framework has two aims. Firstly to manage the overall fiscal position as measured by the National Accounts, and secondly to ensure that departments are subject to incentives to secure value for money and engage in sensible management actions. The current

consolidated budgeting guidance largely follows the FReM, and therefore UKGAAP, in respect of the concepts and measurement of income that it uses, as the budgeting framework aims to capture current revenues and expenditure on an accruals basis in line with the National Accounts measure of spending and receipts.

25. IAS18, without the recommended interpretation, would not be consistent with the budgeting regime for two reasons. Firstly, because the income measure would be inconsistent with National Accounts, and this could free up resources for other areas of spending in a department's budget when no such headroom exists in the overall fiscal position, and, secondly, to include general market movements in the resource budget DEL would expose departments to variations in expenditure that they cannot be expected to manage.

26. Accounting policies that differ from budgeting can also lead to higher compliance costs and confusion, and have the potential to reduce the relevance of the accounts.

### ***Impact on Estimates***

27. In general, the budgeting treatment of income influences the treatment in Estimates. As in the budgeting regime the concepts and measurement of revenue in Estimates is consistent with UKGAAP. Therefore the reasons for interpreting IAS 18 for the public sector context, equally apply to its impact on Estimates.

### ***Summary and recommendation***

28. IASB/FASB are working to develop a new international accounting standard on revenue recognition, replacing the current IAS 18 *Revenue*. Preliminary views from this research project are not due until the second quarter of 2007; however, early work on an accounting model based on an assets and liabilities approach is consistent with UK GAAP (Application Note G) rather than the current IAS 18.

29. IAS 18 allows, but does not require, unrealised profits to be included in the profit and loss account. This, in general, is not consistent with National Accounts or the budgeting and Estimates regime. It is, therefore, recommended that the IFRS-based FReM adopts IAS in full but interprets it for the public sector context by stating that, in general, only profits realised at the balance sheet date shall be included in the profit and loss account. The treatment of unrealised profits in other Standards, such as those resulting from revaluation gains on investment properties (IAS 40), or the movement in the fair value of held-for-trading financial assets (FRS 26) and biological assets (IAS 41) will depend on their interpretation or adaptation for the public sector context.

30. Respondents to the consultation process on IAS 18 (seven departments) supported this view.

31. The Board is invited to approve the proposed text for the IFRS-based FReM at Annex A.

**HM Treasury**  
**11 December 2006**

## **PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL**

### ***Income***

#### **Introduction**

The following accounting standard and interpretation deal with accounting for income:

IAS 18: *Revenue*; and

SIC 31 *Revenue – Barter transactions involving advertising services*.

#### **IAS 18 Revenue**

##### ***Applicability***

IAS 18 Revenue applies in full to all entities covered by this Manual.

##### ***Objectives of IAS 18 Revenue***

The Standard sets out the accounting treatment of revenue arising in the course of an entity's ordinary activities. Revenue is referred to by a variety of different names including sales, turnover, fees, interest, dividends, royalties and rents. It *does not* deal with revenue arising from transactions covered by other Standards, such as:

- Construction contracts (IAS 11);
- Lease agreements (IAS 17);
- Dividends from equity-accounted investments (IAS 28);
- Insurance contracts (IFRS 4);
- Property, Plant and Equipment (IAS 16);
- Changes in the fair value of financial assets and liabilities (IAS 39); and
- Changes in the fair value of biological assets relating to agricultural activity (IAS 41).

## Interpretation of IAS 18 for the public sector context

The following interpretation to IAS 18 applies to all entities covered by this manual.

### *Recognition*

In general, income shall include only those profits realised at the balance sheet date. The treatment of unrealised profits in other Standards, such as those resulting from revaluation gains on investment properties (IAS 40), or the movement in the fair value of held-for-trading financial assets (FRS 26) and biological assets (IAS 41) will depend on their interpretation or adaptation for the public sector context.

### Definitions

The following paragraphs provide definitions of the various types of income that departments covered by the requirements of this Manual might expect to receive. Funding from the following sources should not, however, be accounted for as income but as financing through the General Fund:

- Supply;
- grants and grants-in-aid;
- grants from the Department for constitutional Affairs to the National assembly for Wales;
- amounts from the National Insurance fund in respect of welfare benefits;
- the Consolidated Fund in respect of standing services; and
- advances from the Contingencies Fund.

The parliamentary process and accounting arrangements determine how income is presented. The following sections look at the arrangements for government departments whose activities cover the whole of the United Kingdom, or that are responsible for activities in England or Northern Ireland and the arrangements in Scotland. There are separate arrangements in Wales, details of which can be obtained from the National Assembly for Wales.

Non-departmental public bodies and trading funds should refer to the following definitions as appropriate to their circumstances. There may be situations where, in consultation with their sponsoring bodies, non-departmental public bodies or trading funds cannot retain some of their earned income, but the norm is likely to be that all income earned by these entities will be retained as operating income. Non-departmental public bodies and trading funds should refer to paragraph [X.X.X] for guidance on accounting for grants and grants-in-aid.

### ***Whole of United Kingdom, England and Northern Ireland***

#### ***Operating income and operating appropriations-in-aid***

Operating income is any income generated by an entity in pursuit of its activities (generally referred to as fees and charges) or as part of managing its affairs (examples include rents, interest and dividends receivable). Departments covering the whole of the United Kingdom, and departments covering England or Northern Ireland must seek the approval of the relevant authority and obtain parliamentary approval to retain income, which would otherwise be surrendered to the Consolidated Fund (that is, seek approval to appropriate income in aid of voted expenditure). *Government Accounting* and *Government Accounting Northern Ireland* refer to operating income as operating appropriations-in-aid. In most cases, income will

be retained in support of expenditure on the same Request for Resources, but, subject to its taking out a Supplementary Estimate, a department may retain income against one Request for Resources against related expenditure on another Request for Resource if there is a direct link between the two. Transactions between a department's Requests for Resources in the *Statement of Parliamentary Supply* will be eliminated in the operating cost statement. National insurance contributions receivable by the National Health Service are also accounted for as operating income.

### *Excess appropriations in aid*

Income (either operating or non-operating) in excess of the level authorised by Parliament to be appropriated-in-aid in respect of each RfR is not included in the calculation of net resource outturn. This income is treated as Consolidated Fund Extra Receipts for the purposes of parliamentary control within the Statement of Parliamentary Supply, and is paid into the Consolidated Fund. As excess income is calculated in respect of each RfR, it is possible for there to be excess income even though, in aggregate, income is within the limits approved by Parliament. It is only possible to transfer excess income between RfRs by taking out a Supplementary Estimate.

### *Non-operating income and non-operating appropriations-in-aid*

Proceeds arising from the sale of investments and fixed assets are accounted for as non-operating income. Departments should seek the approval of the relevant authority to appropriate in aid such income. Surpluses on the disposal of assets will be netted off expenditure in the operating cost statement only where they are no more than adjustments to depreciation (or amortisation) or impairment previously charged. The presumption is that this accounting treatment for profits will be more appropriate in respect of depreciable tangible fixed assets which are re-valued, and in respect of other surplus assets originally acquired for an entity's own use, and which have been written down to net realisable value. Other profits on disposal of assets will be treated as income in the operating cost statement. Profits on disposals are netted off the relevant expenditure section in the *Statement of Parliamentary Supply*, rather than appropriated in aid.

### *Other non-retainable income*

Other non-retainable income includes any income or recovery of expenditure that cannot be classified as either appropriations in aid (operating or non-operating) or excess appropriations in aid. It should be recorded in the operating cost statement. In England and Northern Ireland this income is treated as Consolidated Fund Extra Receipts.

### ***EU income***

EU income from whatever source, other than receipts to be transferred to other member states or mandated bodies in other member states in respect of EU twinning projects, should be treated as income and shown separately on a gross basis in the operating cost statement. A distinction should be made on the face of the operating cost statement between receipts where:

- a) the entity is acting as an agent for the European Union in making payments to third parties in the United Kingdom; and
- b) the receipts are treated as negative public expenditure and reduce the burden on the United Kingdom exchequer.

In the case of EU twinning project receipts, amounts to be transferred to other member states to mandated bodies as EU funding for their part in the project are not income in the United Kingdom and so

should be treated as third-party assets as the amounts held represent assets for which the department acts as custodian but in which the government has no beneficial interest.

EU income which is received by an entity in the capacity as an agent passing on the income to a third party may be netted off the relevant expenditure section in the *Statement of Parliamentary Supply*, rather than appropriated in aid. EU income received by an entity to fund its own expenditure should be appropriated in aid.

Where there is a delay in the receipt of EU funds, either direct from the European Union or via the Rural Payments Agency, the amount due should be treated as accrued income and shown in the balance sheet. The notes to the financial statements should disclose separately accrued income relating to EU funding.

### ***Items authorised to be netted off gross expenditure***

Items of income that departments are authorised to net off gross expenditure in the *Statement of Parliamentary Supply* for purposes of parliamentary control, which relate to any recovery of expenditure recorded in the operating cost statement or to returns on investments, should appear in the operating cost statement. Other entities will not normally be authorised to net off income against expenditure. With the exception of EU income [see paragraph X.X.X], no income is recorded in the operating cost statement where an entity is acting as an agent for a principal or on behalf of a third party.

### ***Scotland***

Operating income is income that relates directly to the operating activities of the Scottish Executive, its Executive Agencies, the Crown Office and Procurator Fiscal Service and NHS bodies. It includes fees and charges for services provided, on a full cost basis, to external customers and public repayment work and from investments. Departmental Outturn Statements include both income applied without limit and income applied with limit as outlined by the Scottish Budget documents. For income categorised as being applied with limit, any excess income over that approved is surrendered to the Scottish Consolidated Fund. Operating income is stated net of VAT.

A separate note to the Scottish Executive Consolidated Accounts provides an analysis between income applied and income not applied. Income not applied includes amounts for surrender to the Scottish Consolidated Fund in accordance with the Scotland Act 1998 (Designation of Receipts) Order 2000 and excess receipts not covered by the Budget Act authority, which must by default be surrendered to the Scottish Consolidated Fund. All interest receivable is external to the departmental boundary and is not from other government departments and is included within operating income in respect of Voted Loans and Housing Association Loans.

### ***Grants and grants-in-aid***

Non-departmental public bodies should regard grants and grants in aid received for **revenue** purposes as contributions from controlling parties giving rise to a financial interest in the residual interest of the body, and hence should account for them as financing, i.e. by crediting them to the income and expenditure reserve. The treatment of grants and grants in aid received for **capital** purposes is described in [X.X.X to X.X.X]. Any proposal for alternative accounting treatment should be approved by the department responsible for the NDPB and the relevant authority.

## **SIC 31 Revenue – Barter transactions involving advertising services**

### ***Applicability***

SIC 31 Revenue – Barter transactions involving advertising services applies in full to all entities covered by this Manual.

### ***Objectives of SIC 31***

Entities usually trade for cash or the right to receive cash. Sometimes, however, transactions are undertaken that involve the swapping of goods or services, these are known as barter transactions. IAS 18 does not permit revenue to be recognized in an exchange or barter of similar goods or services, therefore SIC 31 applies to the exchange of dissimilar services; specifically the exchange of advertising on the Internet, on poster sites, on television or radio, published in magazines or journals or through some other medium.

### ***Consensus***

The consensus in the SIC is that revenue from an exchange involving advertising services cannot be reliably measured by reference to the fair value of the services received. This is because reliable information is not available to the seller to support such measurement. However, a seller can reliably measure revenue at fair value of the advertising service it provides in a barter transaction, by reference to non-barter transactions that meet certain criteria specified in SIC 31.