

# Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGFG03-01

12 September 2024 – Online

## Revenue and Inventories

Summary	This paper summarises the key issues raised in the responses to the proposals for accounting for revenue and the related proposals for accounting for inventories.
Purpose/Objective of the paper	To allow PAG members to provide advice on the current proposals for the way forward that will lead to the finalisation of the requirements for accounting for revenue and inventories.
Other supporting items	<a href="#">PAG Paper June 2024, Common grant model for revenue and grant expenses</a>
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Actions for this meeting	<p><u>Advise</u> on the Secretariat’s proposals in respect of:</p> <ul style="list-style-type: none"> <li>• The grant model;</li> <li>• The scope of the permitted exceptions to the recognition and measurement requirements; and</li> <li>• Guidance on low value items donated to an NPO.</li> </ul> <p><u>Note</u> the issues to be resolved at a later date.</p>

# Practitioner Advisory Group

## Revenue and Inventories

### 1. Introduction

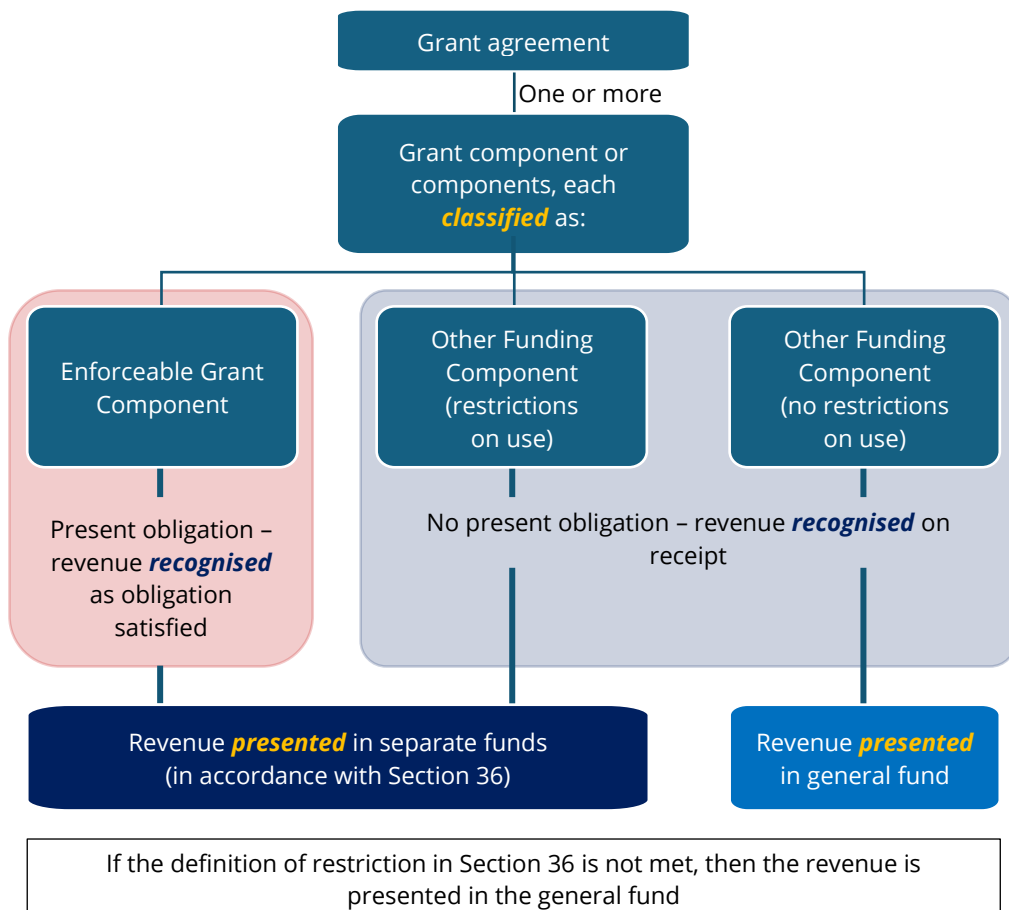
- 1.1 Exposure Draft 2 sought feedback from stakeholders on revenue (Section 23) and Inventories (Section 13), as well as other topics.
- 1.2 This paper seeks PAG member's views on a number of issues identified from the responses to these two sections. These sections are considered together because of the relationship between them. For example, the proposed exceptions to the normal revenue recognition criteria (such as goods donated for resale Section 23) have their equivalents in Section 13, as the normal requirements would require both revenue and inventory to be recognised.
- 1.3 The PAG considered the feedback on the common grant model at its June 2024 meeting. PAG members were mostly content with the grant model for revenue, and this paper updates PAG members on developments since that meeting.
- 1.4 This paper also presents the other key issues identified from the review of the responses to the remaining Specific Matters for Comment that relate to the revenue and inventories sections. PAG members are asked for their views on the issues identified by respondents.

### 2. Grant Model

- 2.1 The common grant model was considered by the PAG in June 2024. Since that meeting, the TAG has also considered the model. Based on the feedback from both the PAG and TAG, only minimal changes are proposed to the draft text included in Exposure Draft 2.
- 2.2 One issue identified by PAG members (as well as by some respondents) was that the focus for accounting purposes should be on individual obligations rather than an arrangement. References to an Enforceable Grant Arrangement or Other Funding Arrangement suggested to some PAG members and respondents that the accounting treatment should be applied to a whole grant agreement.



- 2.3 This was not intended to be the case. These terms were intended to differentiate between different types of obligation. It is the obligation that is the unit of account to which recognition, measurement and disclosure requirements are applied. As a consequence, the Secretariat is now proposing to refer to Enforceable Grant Components (EGC) or Other Funding Components (OFC), being the component within a grant agreement that contains the obligation. This is intended to make clear that a single grant agreement can have components that require different accounting treatments.
- 2.4 The revised model is shown in the diagram below, which also includes the links to the fund accounting requirements in Section 36 *Fund accounting*. The Secretariat intends to include this diagram in INPAG to assist preparers.



**Question 1:** Do PAG members agree with the Secretariat’s proposal to change the focus of the grant model to the obligations in a grant agreement through use of the term components (Enforceable Grant Components and other Funding Components)?

**Question 2:** Do PAG members have any comments on the diagram?

### 3. Other issues

- 3.1 ED 2 sought stakeholders’ views on a range of issues not directly associated with the grant model. The full analysis of the responses to these questions will be available in the September 2024 TAG papers that cover revenue and inventories.
- 3.2 Respondents to ED 2 generally supported the proposals. However, a number of issues were identified, in particular in respect of the proposed permitted exceptions to the general recognition and measurement requirements.
- 3.3 The permitted exceptions proposed in ED 2 (which are not available in respect of Enforceable Grant Arrangements<sup>1</sup>) are as follows:
- NPOs may elect to recognise revenue from low-value assets donated for resale or to be transferred to another party in the course of the NPO’s fundraising activities, when the items are sold or the fundraising activity has taken place. Items for resale would be measured at the amount of the consideration received or receivable.
  - NPOs may recognise revenue from items donated for distribution to service recipients or for an NPO’s own use when the items are distributed or used. These items would be measured at the fair value of the items at the time they are distributed or used.
  - NPOs need not recognise revenue in respect of any services in-kind, except those that are critical to the NPO’s mission.

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<sup>1</sup> To aid the drafting of this paper the terms Enforceable Grant Arrangement (EGA) and Other Funding Arrangement (OFA) have been retained where this refers to the term used in ED2.

*Scope of permitted exceptions*

- 3.4 Some respondents suggested the permitted exceptions should also be applicable to EGAs. ED 2 did not permit this, as deferring the recognition of the items as inventory would affect the liability recognised in respect of an EGA, and would understate the NPO's obligations in respect of the EGA. Revenue from an EGA is recognised (and the liability extinguished) as obligations are satisfied. Deferring revenue recognition until donated items were sold, used or distributed would not be consistent with this approach. Consequently, the Secretariat does not support extending the permitted exceptions to EGAs.
- 3.5 Respondents to ED 2 also raised various other issues regarding the scope of individual permitted exceptions. These comments reflected respondents' differing views as to the balance that needs to be struck between cost-benefit, practicality and faithful representation:
- Some respondents suggested that the exception for low value items donated for resale should be limited to situations when it is impracticable to estimate the value of the item at the time it is received. The Secretariat does not support this proposal for the reasons given in paragraphs 3.6 and 3.7 below.
  - Some respondents noted that deferring recognition of items until they are subsequently distributed or used may not provide much benefit to NPOs. This is because it is unlikely NPOs will have additional information about the value of the inventories from that available when they were received. The Secretariat accepts this will be the case for some items. However, for other items there may be significant uncertainty as to whether the NPO will be able to use or distribute them (for example, medical supplies close to their expiry date). Deferring recognition until to the use or distribution of these items will resolve this uncertainty.
  - Respondents had differing views on when an exception to the recognition of donated services should be permitted. Some considered all donated services should be recognised. Some respondents would permit an exception for volunteer time only, while other respondents would require the recognition of any donated services that the NPO would otherwise have purchased.
- 3.6 The Secretariat accepts that the various suggestions made by respondents are all valid, and are in many cases will reflect what is appropriate in the

respondents' jurisdictions. However, INPAG needs to be applicable internationally, and needs to take into account the capacity of NPOs in all jurisdictions. The exceptions are permissive rather than mandatory. NPOs can choose to apply the general recognition and measurement requirements where they are able, and such information will be useful to the users of the financial statements.

- 3.7 The Secretariat also notes that over two-thirds of respondents supported the proposals in ED 2, and only a few respondents supported each of the suggested alternatives. Consequently, the Secretariat proposes retaining the current scope of the exceptions.

**Question 3:** Do PAG members agree with the Secretariat's proposals to retain the permitted exceptions as they were included in ED 2?

*Guidance on low value items donated to an NPO*

- 3.8 As noted above, INPAG allows NPOs to defer the recognition of revenue and inventories in respect of low value items. A number of respondents suggested that guidance is required as to what constitutes a low value item. The Secretariat agrees that this could be useful.
- 3.9 Some respondents considered that any guidance should be based on materiality, another suggestion was that the guidance should refer to a specific amount.
- 3.10 One respondent noted that IFRS 16 *Leases* provides an exception for low value items and that this approach could be adapted to form the guidance in INPAG.
- 3.11 The approach taken in IFRS 16 can be summarised as follows:
- No absolute value is included in the IFRS 16 standard. However, an indicative figure illustrating the IASB's thinking is provided in the Basis for Conclusions.
  - Low value is an absolute value, not related to materiality. As such, the size and nature of the entity using the exemption is irrelevant.
  - Low value is significantly below the level where items are expected to be material, even in aggregate. The IASB's intention (set out in the Basis for Conclusions) was to include an exception that all entities could use

without incurring the burden of demonstrating that the relevant items were not material.

- Entities can therefore apply the exception to individual items rather than to all items in a class. Other exceptions in IFRS 16 must be applied to all items in a class.
- 3.12 The Secretariat can see advantages in adapting the approach in IFRS 16 for donations of items for resale, distribution or the NPO's own use. In particular, there would be benefits to NPOs by removing the need to determine whether items to which the exception is applied are material.
- 3.13 The Secretariat is, therefore, minded to include guidance on low value items that would treat low value as an absolute amount, with an indicative amount included in the Basis of Conclusions.
- 3.14 Given the range of NPOs to which INPAG might apply, any value would need to be set fairly low to ensure it was below materiality thresholds, individually and in aggregate. The value would apply to each individual item donated. The Secretariat is seeking views from both the PAG and the TAG on this approach and on the appropriate value. Subject to this feedback, the Secretariat considers that US \$100 could be an appropriate amount.
- 3.15 The Secretariat appreciate that while US \$100 might be appropriate for many countries, it may be too high (or too low) for others. A comment could be made in the Basis for Conclusions that local regulators may wish to provide further guidance that includes a different value to be used in their country.
- 3.16 The Secretariat is also minded to permit NPOs to apply the low value exception on an item by item basis rather than to all items within a class of inventories. This would allow NPOs to recognise donated items where the value was clear without having to determine a value for all other items in the class. Because the items are not expected to be material, this should not affect the faithful presentation of the financial statements.

**Question 4:** Do PAG members support the Secretariat's proposed approach to providing guidance on low value donated items?

**Question 5:** Do PAG members consider that US \$100 is an appropriate amount for low value items? If not, what value would they suggest?

**Question 6:** Do PAG members agree that NPOs should be able to apply the low value exception on an item by item basis?

*Issues to be resolved at a later date*

3.17 Respondents also identified a number of other issues that will need to be considered in finalising INPAG. In some cases, the resolution of these issues will be affected by ongoing developments, and the Secretariat therefore proposes to consider the following issues at a later date:

- Guidance on fair value. Respondents suggested that guidance on fair value would be required. Such guidance is included in ED 3, and the Secretariat will review the responses to the revenue and inventories sections alongside the responses to the fair value section in ED 3.
- Guidance on impairment. Respondents suggested that guidance on assessing inventories for impairment would be required. Such guidance is included in ED 3, and the Secretariat will review the responses to the revenue and inventories sections alongside the responses to the impairment section in ED 3.
- Complexity of requirements. Some respondents suggested that the guidance was overly complex and required simplification. The IASB is currently finalising the text of the 3<sup>rd</sup> Edition of the *IFRS for SMEs* Accounting Standard. This finalisation process includes reviewing the text of the revenue section with a view to simplifying the wording and using plain English where possible. This text will form the basis of Part II of Section 23 in INPAG, and the Secretariat will also review the changes made with a view to incorporating any simplified wording in Part I.

3.18 PAG members are asked to note these issues, which may be brought to future PAG meetings if they are not resolved by the ongoing developments.

September 2024