



Staff Paper

Dec 2010, Agenda Paper 8.3

Income from Non-Exchange Transactions—Categories of Obligations

Purpose of this Paper

1. This paper illustrates the different categories of obligations that can arise under transactions addressed within this project.¹ It is intended to illustrate some implications of the Boards' decision in March 2010 that each of a performance obligation and a return obligation would qualify as a liability on a standalone basis. It is also intended to illustrate the circumstances in which some obligations incept and are extinguished or transformed into other obligations.
2. This paper responds, in part, to a concern expressed by some respondents to ED 180/ED 118 that the relationship between advance receipts obligations and other obligations is unclear. However, its coverage is much broader than advance receipts.
3. This paper will be extended for the next meeting of each Board to discuss possible measurement treatments. That extended version of this paper will complement a paper on liability measurement for consideration at that meeting.
4. Assuming that each obligation that exists is recognised, a measurement issue that will need to be addressed is how to measure a concurrent performance obligation and return obligation arising from a single transfer. The illustrations below of concurrent performance obligations and return obligations are, therefore, mainly of relevance to the future consideration of measurement issues.
5. At this Board meeting, the staff seeks the views of Board members on whether they agree with the analysis of the nature and timing of the various obligations in the following examples. Reaching agreement on these aspects would mean that, when measurement of

¹ AASB and NZICA staff note that, in light of recent decisions on this project, careful re-examination of the scope of this project will be required. For example, some of the guidance being developed might apply to exchange components of transactions that also have non-exchange components. Also, some Board members expressed a view that the exchange/non-exchange distinction should be removed. A paper re-examining the scope of the project will be prepared for a future meeting of each Board.

liabilities is addressed in forthcoming agenda papers, agreement already exists on the subject of measurement. This should aid deliberations on measurement issues.

Question for Board members

Q1 Do you agree with the analysis of the nature and timing of the various obligations in the four examples in this paper?

Examples

The first example is a transaction that is wholly exchange in nature and gives rise to both a performance obligation and a return obligation. This example provides a point of comparison for the following examples.

Example 1—Exchange Transaction for the Rendering of Services

Local Government A is contracted by the national government to trap and relocate crocodiles that encroach on areas of likely human contact. The contract is for twelve months, and the activity is performed continuously throughout that period. The fee of \$600,000 for this service is paid in advance on 2 January 20X0, at which time a binding arrangement is created. Any unearned portion is refundable to the national government. The reporting date for Local Government A is 30 June each year.

Event and timing	Return obligation?	Performance obligation?
Fee for service paid in advance on 2 January 20X0	Return obligation for unearned portion of the fee (not an advance receipt obligation)	Performance obligation to provide the service
During the period from 2 January 20X0 to 30 June 20X0, six months' fee income is earned by Local Government A	Return obligation for unearned portion of the fee	Performance obligation to provide the service
Reporting date of 30 June 20X0	Return obligation for unearned portion of the fee	Performance obligation to provide the service
During the period from 1 July 20X0 to 31 December 20X0, six months' fee income is earned by Local Government A	Return obligation for unearned portion of the fee	Performance obligation to provide the service
31 December 20X0	No return obligation	No performance obligation

Example 2—Transfer to a University with Stipulations

Example 11 in the Illustrative Guidance in ED 180/ED 118 provides the following fact pattern and proposed treatment (see the original text below). The example and treatment are modified by marking up to add pertinent details and reflect the Boards’ decision in March 2010 that an accompanying return obligation is not essential for a performance obligation to qualify as a liability.

On 2 January 20X0, the national government (transferor) transfers 200 hectares of land in a major city to a university (reporting entity) for the establishment of a university campus. The transfer agreement specifies that university campus buildings with a capacity for 10,000 students and 1,500 academic staff are to be built on the land, is to be used for a campus, but does not specify that the land is to be returned if not used for a campus the campus buildings are not constructed. Nevertheless, the government can enforce the construction of the campus buildings through legal or equivalent means. There are no other stipulations attached to the transfer.

The university recognises the land as an asset in the statement of financial position of the reporting period in which it obtains control of that land. The land should be recognised at its fair value in accordance with AASB 116 / NZ IAS 16 *Property, Plant and Equipment*. Its fair value is \$800 million. The restriction does not meet the definition of a liability or satisfy the criteria for recognition as a liability. Therefore, Because the government can enforce the construction of the campus buildings through legal or equivalent means, the university recognises income in respect of the land in the statement of financial performance of the reporting period in which a liability for its enforceable performance obligation when the land is recognised as an asset. The binding transfer agreement is entered into simultaneously with the transfer of control of the land. Therefore, there is no advance receipt.

This example and its treatment are set out below in a similar format to the other examples in this paper. It is also assumed that construction of the buildings is completed in November 20X0, and that the reporting date for the university is 31 December each year.

Event and timing	Return obligation?	Performance obligation?
On 2 January 20X0, land with a fair value of \$800 million is transferred to the university	There is no advance receipt and no other return obligation	Performance obligation to construct the campus buildings
Construction of campus buildings is performed from 2 January 20X0 to 30 November 20X0	No return obligation	Performance obligation to construct the campus buildings
Reporting date of 31 December 20X0	No return obligation	No performance obligation

Example 3—Advance Receipts of Income Tax (Example 8 in ED 180/ED 118)

Example 8 in the Illustrative Guidance in ED 180/ED 118 provides the following fact pattern and proposed treatment:

Government A (reporting entity) levies income tax on all residents within its jurisdiction. The tax period and the reporting period are January 1 to December 31. Self-employed taxpayers are required to pay an estimate of their income tax for the year by December 24 of the year immediately preceding the commencement of the tax year. The tax law sets the estimate as the amount due for the most recently completed assessment, plus one tenth, unless the taxpayer provides an explanation prior to December 24 of a lower amount (penalties apply if the taxpayer's assessment proves to be materially lower than the final amount owed). After the end of the tax period, self-employed taxpayers file their tax returns and receive refunds, or pay additional tax to the government.

The resources received from self-employed taxpayers by December 24 are advance receipts against taxes due for the following year. The taxable event is the earning of income during the taxation period, which has not commenced. The reporting entity recognises an increase in an asset (cash in bank) and an increase in a liability (advance receipts).

This example and its treatment are set out below in a similar format to the other examples in this paper. The example is modified to focus on payments by a particular taxpayer, to assume that the first instalment of 'provisional tax' paid is \$100,000, and that additional instalments of provisional tax totalling \$300,000 are received from the taxpayer by Government A during the tax period. When the taxpayer's tax assessment is issued, it is determined that there is no amount refundable to the taxpayer.

Event and timing	Return obligation?	Performance obligation?
First instalment of provisional taxation paid 24 December 20X0	Advance receipt liability (return obligation)	No performance obligation ²
During the period from 1 January 20X1 to 31 December 20X1, taxable income is earned by the taxpayer and further provisional tax instalments are paid to Government A.	<p>To the extent that tax instalments precede the earning of taxable income during the period, an advance receipt liability exists.</p> <p>To the extent that Government A estimates that the taxpayer has incurred income tax by earning taxable income, the advance receipt liability ceases to exist.</p> <p>The advance receipt liability is increased by each tax instalment paid, and is progressively extinguished throughout the tax period because the taxable event is the taxpayer's earning of taxable income during the tax period. Any estimated balance of the advance receipt liability remaining at the end of the tax period would be replaced with an unconditional obligation to make a refund (return obligation).</p> <p>The estimated extinguishment of advance receipt obligations gives rise to a return obligation. This return obligation is the obligation to stand ready to make a refund if, contrary to estimates, the tax instalments exceed the tax assessed.</p>	No performance obligation

² ED 180/ED 118 (paragraph 65) notes that specific purpose tax levies may give rise to conditions on transferred assets, which include performance obligations. For the purposes of this example, it is assumed that the income tax is a general purpose tax.

At Government A's reporting date of 31 December 20X1, all taxable income relating to the taxpayer's tax instalments has been earned, but a tax return has not been received.	The advance receipt obligation has been fully extinguished. Government A has a stand-ready obligation to refund tax instalments if they exceed the tax assessed (return obligation).	No performance obligation
Income tax assessment issued 28 February 20X2	No return obligation	No performance obligation

Identifying return obligations as liabilities regardless of whether they are accompanied by a performance obligation has a potential implication for the treatment of income tax. This example illustrates that a return obligation exists after the taxable event occurs because, until the tax assessment is issued by the taxation authority, the government has an obligation to stand ready to refund tax instalments received.

ED 180/ED 118 specifies when an asset is recognised for taxes but does not specify when resulting income is recognised. Paragraph 60 of the ED states that “An entity shall recognise an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met”. Paragraph 66(a) of the ED says it is likely that the taxable event for income tax is the earning of taxable income during the taxation period by the taxpayer. In addition, Example 1 in the Implementation Guidance accompanying the ED says “At the end of the reporting period, the government recognises assets **and income** in respect of personal income tax on the taxable income earned during the reporting period to the extent that it can reliably measure it” (paragraph IG2, emphasis added).

This paper does not address the issue of whether a return obligation gives rise to deferred income (contrary to the implication in Example 1 in the Implementation Guidance accompanying ED 180/ED 118) or an expense. That issue will be addressed in a forthcoming paper that also deals with the measurement of liabilities within the scope of this project. (The measurement approach adopted will also affect the timing of income recognition.)

Example 4—Matching Grants for the Construction and Maintenance of a New Bridge

Local Government B receives a grant of \$80 million from the national government on 15 May 20X0 as a contribution of half the estimated cost of constructing a new bridge. The grant is provided on the condition that a matching grant is provided by the relevant state government, to enable the bridge to be built without Local Government B financing the bridge's construction with debt or increased rates. If a matching grant is not obtained, the national government grant must be returned.

The grant and its deployment are the subject of an agreement, which is not entered into by Local Government B until its council completes its due diligence on the construction project and the likelihood of obtaining a matching grant from the state government. Local Government B's reporting date is 30 June each year. The agreement becomes binding on 15 July 20X0. Under the terms of that agreement, the national government grant is refundable in full if the bridge is not

constructed to an adequate standard within two years of entry into the agreement (i.e., by 14 July 20X2).

Local Government B obtains a matching grant of \$80 million from the state government on 31 July 20X0. On the same day, a binding agreement between Local Government B and the state government is entered into. Under the terms of that agreement:

- (a) the state government grant is refundable in full if the bridge is not constructed to an adequate standard within two years of entry into the agreement (i.e., by 30 July 20X2); and
- (b) Local Government B must maintain the bridge for twenty years after its completion. The state government has the capacity to enforce this promise by legal or equivalent means. However, there are no refund provisions attaching to this promise.

On 28 February 20X2, Local Government B completes construction of the bridge to an adequate standard, and representatives of both the national and state governments sign off on adequate completion.

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Event and timing	Return obligation?	Performance obligation?
Local Government B receives national government grant, without a binding agreement, on 15 May 20X0	Advance receipt liability (return obligation)	No performance obligation (no binding agreement)
Reporting date of 30 June 20X0	Advance receipt liability (return obligation)	No performance obligation (no binding agreement)
Agreement with national government becomes binding on 15 July 20X0	Return obligation arises (obligation to stand ready to return national government grant if bridge not built by 14 July 20X2). This is no longer an advance receipt obligation.	Performance obligation arises to build the bridge by 14 July 20X2
Local Government B receives state government grant, upon entering a binding agreement, on 31 July 20X0	Return obligation arises (obligation to stand ready to return state government grant if bridge not built by 30 July 20X2). This is not an advance receipt obligation.	Performance obligation arises to build the bridge by 30 July 20X2. Performance obligation arises to maintain the bridge for twenty years.
Period from 31 July 20X0 until 28 February 20X2	Obligations exist to stand ready to return grants to both the national government and state government if the bridge is not built by the specified dates.	Performance obligations to both the national government and state government to build the bridge. Performance obligation to maintain the bridge for twenty years is owed to the state government.
Construction of the bridge is completed on 28 February 20X2	Both return obligations are extinguished.	Performance obligations to build the bridge are extinguished. Performance obligation to maintain the bridge for another twenty years is owed to the state government.
Reporting date of 30 June 20X2	No return obligation	Performance obligation to maintain bridge for another 19 years and 8 months.