



Staff Paper

Feb 2011, AASB Agenda Paper 10.4 / FRSB Agenda Paper B7.4

Income from Non-Exchange Transactions – Measurement of Financial Assets and Financial Liabilities Arising from Non-Exchange Transactions

Proposal in ED 180/ED 118

1. AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* proposed that financial assets and financial liabilities arising from non-exchange transactions be measured in accordance with AASB 139 / NZ IAS 39 *Financial Instruments: Recognition and Measurement*. Thus, for example, financial assets and financial liabilities arising from non-exchange transactions would initially be measured at fair value adjusted for any transaction costs.¹ This paper discusses whether to confirm that proposal in the light of the submissions received and other developments.

Comments by Respondents to AASB ED 180/FRSB ED 118

2. Of the seventeen respondents to ED 180/ED 118 who commented on this proposal, fourteen² agreed. Of them, three³ asked for further clarification of the required treatment, and one⁴ questioned whether the benefits of applying the proposal would justify the costs.
3. Two respondents⁵ disagreed because of the difference between the treatment of financial and non-financial assets. As mentioned in AASB Agenda Paper 10.3 / FRSB Agenda Paper B7.3, AASB staff observe that this difference is not specific to the proposals in ED 180/ED 118. Rather, it exists in IFRSs and IPSASs generally. Therefore, staff suggests this project is not the place to address that difference.

¹ ED 180/ED 118, paragraphs 43, 58, BC 14 and BC 16

² DG & AG Maxwell, VTUSFOG, Joint Accounting Bodies, WA Department of Local Gov't, ACAG, KPMG (Aust), PwC (Aust), South Aust. Treasury; Aust Uni. Group, Grant Thornton, PwC (NZ), KPMG (NZ), Auckland Uni. and Salvation Army

³ DG & AG Maxwell, Grant Thornton and Auckland Uni.

⁴ Salvation Army

⁵ HoTARAC and Finance Department

4. The respondents referred to in paragraph 3 also criticised the different measurement bases for financial liabilities and advance receipts liabilities. Because the Boards tentatively agreed in October 2010 that advance receipts are a form of return obligation, and because return obligations are proposed to be accounted for under the measurement requirements of the domestic Standards that incorporate the IFRS on Revenue from Contracts with Customers,⁶ that issue is addressed separately in AASB Agenda Paper 10.7 / FRSB Agenda Paper B7.7.
5. Another respondent, which did not express an overall view on this proposal,⁷ said AASB 139 and NZ IAS 39 have specific requirements on initial measurement, including situations in which the transaction price may differ from the fair value of the financial asset or financial liability on initial recognition. The respondent argued further guidance should be included in ED 180/ED 118 to make it clear that while AASB 139/NZ IAS 39 is referred to for measurement, any difference between the assets and liabilities recognised is accounted for as per ED 180/ED 118 and not AASB 139/NZ IAS 39. AASB and NZICA staff note that the Boards' Basis for Conclusions on ED 180/ED 118 addresses this issue. It says:

“... the Boards note that AASB 139 / NZ IAS 39 (paragraph AG76) does not allow the restatement of a transaction amount to fair value on initial recognition when fair value is determined only on the basis of a valuation technique whose variables include non-observable inputs. The Boards consider that any difference between transaction amounts and fair value ought to be recognised in respect of non-exchange transactions, as the difference is part of the entity's gain or loss on the transaction. That is, the Boards would extend the recognition of “day 1” gains and losses to any difference between non-exchange transaction amounts and fair value, not just those that AASB 139 / NZ IAS 39 would require to be recognised, affecting the amount of income to be recognised in relation to such a transaction. Non-exchange transactions often will be undertaken at amounts different from a fair value based on either observable or unobservable inputs.” (paragraph BC17)

Therefore, staff think this issue raised by the respondent is covered adequately by the ED. However, for reasons unrelated to this respondent's concern, staff proposes removing the

⁶ See AASB Agenda Paper 10.7 / FRSB Agenda Paper B7.7 for background.

⁷ Ernst & Young

departure from IAS 39 (now IFRS 9) proposed in paragraph BC17 of ED 180/ED 118— see paragraphs 9 – 11.

6. The respondent referred to in paragraph 5 also said:
 - (a) it is unclear when to apply the requirements in AASB 139/NZ IAS 39 on the classification of financial assets and liabilities, and their subsequent measurement in the ED; and
 - (b) another consideration is that once a return obligation is triggered, the entity would be required to reverse the performance obligation (a non-financial liability) and recognise the return obligation (a financial liability). Differences in measurement may arise upon such occurrence, but that this is not addressed in the ED.
7. Staff thinks the concern in paragraph 6(a) would be resolved by the Boards' tentative decision not to retain the proposal in ED 180/ED 118 that a 'condition on transferred assets' (a performance obligation accompanied by a return obligation) must exist for a liability to be recognised. Therefore, there would be no need to retain the exception from the recognition requirements in AASB 139/NZ IAS 39 that was proposed in ED 180/ED 118. (For background, see paragraph BC15 of the Boards' Basis for Conclusions on that ED and the Boards' proposed consequential amendments to AASB 139 and NZ IAS 39 set out in the ED's Appendix A, paragraph A5 and Appendix B, paragraph B10, respectively.) In relation to return obligations (a form of financial liability), it should be borne in mind that the IASB proposes accounting for return obligations under the IFRS on Revenue from Contracts with Customers rather than IFRS 9 *Financial Instruments*. AASB staff propose that PBEs/NFPs should account for return obligations consistently with the treatment under the IFRS on Revenue from Contracts with Customers (see AASB Agenda Paper 10.7 / FRSB Agenda Paper B7.7).
8. In relation to the concern in paragraph 6(b), staff notes that, under the proposals in the IASB ED on Revenue from Contracts with Customers, performance obligations and return obligations would each be recognised as liabilities. The recognition of a return obligation would not be delayed until the occurrence of an event that makes a return of economic

benefits to another party unconditional. Instead, such an event would be reflected in the measurement of the respective obligations. Therefore, staff thinks generally conforming to the recognition and measurement proposals in the IASB ED would overcome this concern.

Evidence of difference between transaction amount and fair value

9. Two respondents⁸ expressed concern that the effect of paragraph BC17 of ED 180/ED 118 (quoted above in paragraph 5) is unclear. Paragraph BC17 proposes departing from the requirement now in paragraph B5.4.8 of IFRS 9 that ‘day one’ gains/losses in relation to financial assets and financial liabilities arising from differences between the transaction amount and fair value may only be recognised when all of the variables that are inputs to the fair value estimate are observable. For the reasons in paragraphs 10 – 11, staff think the Boards should reconsider their decision to depart from the restriction formerly in AASB 139/NZ IAS 39 on when initial fair value estimates for financial assets and financial liabilities can depart from transaction price. This proposal, among other things, would address the concern noted in the first sentence of this paragraph.
10. Since the Boards issued ED 180/ED 118, the IASB ED on Revenue from Contracts with Customers proposed that ‘refund liabilities’ (termed ‘return obligations’ in the staff papers for the project on income from non-exchange transactions) should be measured under the IFRS on Revenue, rather than IFRS 9. Therefore, a major category of financial liabilities arising from transactions within the scope of this project would fall outside the scope of the proposed exception to IFRS 9 (formerly IAS 39) discussed in paragraph BC17 of ED 180/ED 118. The other main category of financial liabilities of which staff are aware is loans, which might be provided to a PBE/NFP at concessional rates of interest. Staff consider that the inputs to estimates of the fair value of concessional loans received should generally be observable, in which case the proposed departure from IFRS 9 should be unnecessary.
11. An example of a type of financial asset that might arise from a transaction at an off-market price and require some non-observable inputs is a government’s student loans granted for

⁸ HoTARAC and Finance Department. These respondents also queried how such a change to the requirements of AASB 139/NZ IAS 39 could be made in a Basis for Conclusions. In view of the staff’s proposal on this issue generally, that issue is not explored in this paper.

higher education that are repayable only when a student meets certain conditions, such as earning above a threshold level of taxable income. However, from the lender government's perspective, the concessional element of the transaction gives rise to an expense, and therefore falls outside the scope of ED 180/ED 118.

Applicability of IFRS 9 to contract assets

12. Paragraph 35 of the IASB ED on Revenue from Contracts with Customers says the transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer. If an entity has delivered goods or services to the customer, under the [proposed] IFRS on Revenue from Contracts with Customers it seems that the entity would recognise its contract asset (receivable) at an amount that may differ from that asset's fair value, even when it is a right to receive cash or other financial assets (which would normally be the case). From discussions with IASB staff, it is not clear at this stage which contract assets would fall within the Revenue IFRS for measurement purposes and which contract assets would fall within the measurement requirements of IFRS 9.
13. This development does not raise an issue regarding how to measure financial assets accounted for under the Financial Instruments IFRSs. It is noted to alert Board members that the scope of the proposed measurement requirements discussed in this paper might be limited in relation to contract assets. Staff is not aware of any PBE/NFP-specific issues arising in relation to the IASB proposal discussed in paragraph 12. Therefore, this paper does not contain any recommendations on this IASB proposal.

Staff recommendations

14. In view of the strong support in submissions on the ED for the proposal that financial assets and financial liabilities should be measured (initially and subsequently) in accordance with AASB 139 / NZ IAS 39, AASB staff recommend retaining that proposal. The AASB and FRSB have recently issued AASB 9 *Financial Instruments* and NZ-IFRS 9 *Financial Instruments*, which largely replace AASB 139 and NZ IAS 39, respectively.

(For example, measurement requirements for financial assets and financial liabilities are now set out in AASB 9 and NZ IFRS 9.)

15. As mentioned in paragraph 10, under the proposals in the IASB ED on Revenue from Contracts with Customers, return obligations would not be accounted for under AASB 9 and NZ IFRS 9. However, other financial liabilities (such as loans) may arise from transactions within the scope of ED 180/ED 118, and the staff's recommendation in paragraph 14 would apply to these other financial liabilities. The measurement of return obligations is discussed separately in AASB Agenda Paper 10.7 / FRSB Agenda Paper B7.7.
16. Staff consider that it would be unnecessary for the revised ED succeeding ED 180/ED 118 to depart from the restriction in IFRS 9 on when initial fair value estimates for financial assets and financial liabilities can depart from transaction price. This is because the departure is no longer needed, based on the reasons in paragraphs 10 – 11.

Questions for Board members

- Q1** Do you agree that the revised ED should propose that PBEs/NFPs should measure financial assets and financial liabilities (initially and subsequently) in accordance with AASB 9 and NZ IFRS 9, except when other IFRSs apply to those assets and liabilities? That is, do you agree that no PBE/NFP-specific modification should be made to the measurement requirements in IFRSs for financial assets and financial liabilities?
- Q2** Do you agree that the revised ED should not retain the proposal in ED 180/ED 118 to depart from the restriction in IFRS 9 on when initial fair value estimates for financial assets and financial liabilities can depart from transaction price? Are there circumstances for which the proposed departure should be retained?