



Staff Paper

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Income from Non-Exchange Transactions – Measurement of Return Obligations and Advance Receipts Liabilities

Measurement of Return Obligations

Proposal in ED 180/ED 118

1. AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* did not set out explicit proposals for the measurement of return obligations. Paragraph 58 of the ED says: “The amount recognised as a liability (other than advance receipts) shall be the best estimate of the amount required to settle the present obligation at the reporting date, except that financial liabilities shall be measured in accordance with AASB 139/NZ IAS 39”. Many return obligations would be obligations to return cash or other financial assets, and therefore would be financial liabilities. The ED’s proposed measurement approach for financial liabilities (including the comments of respondents on that proposal) is discussed in AASB Agenda Paper 10.4 / FRSB Agenda Paper B7.4.

Proposal in IASB ED on Revenue from Contracts with Customers

2. As noted in AASB Agenda Paper 10.4 / FRSB Agenda Paper B7.4, the IASB ED on Revenue from Contracts with Customers proposes that ‘refund liabilities’ should be measured under the requirements proposed in that ED, rather than under IFRS 9 *Financial Instruments*, even though refund liabilities are financial liabilities if the refund would be provided in cash or other financial assets. (These liabilities have been termed ‘return obligations’ in the staff papers for the project on income from non-exchange transactions.) Paragraphs 3–7 outline the measurement treatment of refund liabilities proposed in the IASB ED, note advantages and a disadvantage of that treatment and discuss whether there is a PBE/NFP-specific reason to modify that treatment.
3. Paragraph 37 of the IASB ED says “If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall

recognise a refund liability ... [and measure it] at the probability-weighted amount of consideration that the entity expects to refund to the customer (ie the difference between the amount of consideration received and the transaction price).” This proposal is illustrated by Example 3 in the proposed Application Guidance (Appendix B) in the IASB ED, which is reproduced below:

Example 3—Right of return

An entity sells 100 products for CU100 each. The entity’s customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The cost of each product is CU60. The entity estimates a 25 per cent probability that one product will be returned, a 50 per cent probability that three products will be returned, and a 25 per cent probability that five products will be returned. Therefore, the entity expects that three products will be returned ($[1 \times 25\%] + [3 \times 50\%] + [5 \times 25\%]$).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the products, the entity would not recognise revenue for the three products it expects to be returned. Consequently, the entity would recognise:

- (a) revenue of CU9,700 ($CU100 \times 97$ products expected not to be returned);
- (b) a refund liability for CU300 ($CU100 \times 3$ products expected to be returned); and
- (c) an asset of CU180 ($CU60 \times 3$ products) for its right to recover products from customers on settling the refund liability. Hence, the amount recognised in cost of sales for 97 products is CU5,820 ($CU60 \times 97$).

4. Some AASB members have previously said a refund liability is a financial liability¹ with a demand feature, particularly if non-performance of the performance obligation is beyond the control of the entity (e.g., the entity may need to obtain regulatory approval to proceed with a key activity). They consider that, in applying IFRS 9, an entity would need to measure the fair value of a refund liability at an amount not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. ED 180 proposed measuring financial liabilities in accordance with the domestic Standards incorporating IAS 39 *Financial Instruments: Recognition and Measurement* (subsequently superseded by the domestic Standards incorporating IFRS 9). If refund liabilities were

¹ that is, if the refund would be provided in cash or other financial assets

measured under the relevant Financial Instruments Standard at the amount contingently refundable, their measures would seem to differ significantly from the *probability-weighted* amount of consideration that the entity expects to refund to the customer, as proposed in the IASB ED.

5. Advantages of measuring refund obligations in accordance with the proposals in the IASB ED are that:
 - (a) reflecting the probability of a refund provides more useful information than not doing so, because the probability of refund can differ considerably for different transactions. Reflecting the probability of refund provides useful information for assessing the entity's future cash (and other resource) flows. It is consistent with the principle that different phenomena should look different and similar phenomena should look alike;
 - (b) if refund liabilities accompanied by performance obligations are measured at the amount contingently refundable (i.e., without taking probability into account), recognising the performance obligation as well as the return obligation would seem likely to cause recognition of a loss upon initial recognition of each such transaction. This would not seem representationally faithful; and
 - (c) the probability of an outflow would be treated consistently in measuring performance obligations and return obligations.
6. The disadvantage of measuring refund obligations differently from other financial liabilities is that financial liabilities would be measured differently according to the Standard applying to them.
7. AASB staff think the advantages of the IASB's proposed measurement basis for refund liabilities outweigh the disadvantages. In addition, staff are not aware of a PBE/NFP-specific reason to modify the treatment of refund liabilities in the IASB ED.

Staff recommendation

8. AASB staff recommend that PBEs/NFPs should measure return obligations in accordance with the IASB Revenue ED’s proposal—namely, at the probability-weighted amount of consideration that the entity expects to refund to the transferor.

Question for Board members

- Q1** Do you agree that PBEs/NFPs should measure return obligations in accordance with the IASB Revenue ED’s proposal?

Measurement of Advance Receipts Liabilities*Nature of Advance Receipts Liabilities*

9. Paragraph 26 of ED 180/ED 118 says: “In this Standard ‘advance receipt’ refers to resources received prior to a taxable event or a transfer arrangement becoming binding.” The Basis for Conclusions on ED 180/ED 118 notes that, in the event that the taxable event did not occur, or the transfer arrangement did not become enforceable, the entity may need to return part or all of the resources (paragraph BC20).

Proposal in ED 180/ED 118

10. ED 180/ED 118 proposed that liabilities for advance receipts should be recognised at an amount equal to the amount of the advance receipt (paragraph 54).²

Comments by Respondents to AASB ED 180/FRSB ED 118

11. Of the six respondents to ED 180/ED 118 who commented on this proposal, three³ agreed, two⁴ disagreed and one⁵ did not express an overall view but expressed some concerns.

² This principle is stated explicitly only in respect of advance receipts of taxes. Paragraph 54 of the ED says liabilities for advance receipts of taxes are recognised at “an amount equal to the amount of the advance receipt”. Nevertheless, the staff’s understanding is that this principle also applies to advance receipts of transfers.

³ Joint Accounting Bodies, KPMG (Aust) and South Aust. Treasury

⁴ HoTARAC and Finance Department

12. The respondents who disagreed did so because of the difference between the measurement treatment of non-financial liabilities, financial liabilities and advance receipts. In December 2010, the AASB and FRSB tentatively decided advance receipts are a form of return obligation, which often is a financial liability. AASB staff observe that the difference between the measurement of advance receipts (when they are financial liabilities) and non-financial liabilities 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.
13. The other aspect of those respondents' concerns is the proposal to measure advance receipts differently from other financial liabilities. ED 180/ED 118 proposed measuring advance receipts at the same amount as the asset (i.e., measuring a liability by reference to an inflow of assets rather than a future outflow that will be required), when financial liabilities are initially measured at fair value plus transaction costs. Staff thinks this concern would be overshadowed by the proposal in the IASB ED on Revenue from Contracts with Customers that return obligations should not be measured as a financial liability under IFRS 9. In paragraph 8, staff recommend conforming to that IASB proposal in respect of PBEs/NFPs. In addition, the IASB ED proposes measuring return obligations by reference to the future outflow of assets that will be required. Therefore, the respondents' concern with the proposal to measure advance receipts differently from other financial liabilities is not explored further in this paper.
14. One respondent not expressing an overall view on the issue⁶ commented that it is unclear when to apply the requirements of AASB 139/NZ IAS 39 *Financial Instruments: Recognition and Measurement* on the classification of financial liabilities, such as advance receipts, and their subsequent measurement, rather than the proposed requirements in ED 180/ED 118. For example, this arises when a financial liability arises on initial recognition because of an advance receipt. The respondent said it appears that these financial liabilities are intended to be dealt with under the ED, but are not scoped out of AASB 139/NZ IAS 39. As mentioned in paragraph 8, staff propose conforming to the

⁵ Ernst & Young

⁶ Ernst & Young

IASB ED proposal that return obligations (which include advance receipts) should be measured under the IFRS on Revenue from Contracts with Customers. IASB staff have advised AASB staff that the Revenue IFRS would explicitly scope return obligations out of the IFRSs dealing with financial instruments. Reflecting that proposal in the revised ED that succeeds ED 180/ED 118 should adequately address this respondent's concern.

Applying the IASB's Proposed Measurement Approach for Return Obligations to Advance Receipts

15. The Boards' tentative decision that advance receipts are a form of return obligation implies that advance receipts should be measured consistently with other return obligations. As noted in paragraph 8, the staff proposes that PBEs/NFPs should measure return obligations in accordance with the IASB Revenue ED's proposal—namely, at the probability-weighted amount of consideration that the entity expects to refund to the customer. Paragraphs 16 – 17 discuss the implications of using that measurement approach for advance receipts.
16. In cases where the probability of a transfer arrangement not become binding or a taxable event not occurring is low, the “probability-weighted amount of consideration that the entity expects to refund to the customer” would appear to be a small percentage of the amount of assets received. Arguably:
 - (a) a performance obligation cannot arise from a transfer (such as a grant) until the arrangement becomes binding; and
 - (b) generally, a performance obligation does not arise from receiving taxes.
17. If the views in paragraph 16 were adopted, in the cases where the probability of a transfer arrangement not become binding or a taxable event not occurring is low, most of the amount of assets received before a transfer arrangement becomes binding or a taxable event occurs would be recognised as income when control is obtained over the transferred assets. Where a grant arrangement becomes binding in the reporting period after recognition of the transferred assets, and performance obligations arise when the arrangement becomes binding, the recognition of the performance obligations would give

rise to a corresponding expense. This outcome (recognition of income in the period in which the transfer occurs, followed by recognition of an expense when the arrangement becomes binding) would seem inconsistent with the economic substance of the arrangement.

Advance Receipts from Transfers

18. AASB staff think an entity's obligations in respect of advance receipts are not necessarily limited to the obligation to return part or all of the resources if the transfer arrangement does not become binding. Consider, for example, a transfer agreement that has yet to become binding but sets out in specific detail the enforceable performance obligations the transferee will incur when the arrangement becomes binding.
19. AASB staff think that, in the circumstances described in paragraph 18, the transferee's obligations arising from the receipt of assets before the transfer agreement becomes binding would comprise:
 - (a) an obligation to stand ready to return the transferred assets (or pay equivalent compensation) if the arrangement does not become binding;
 - (b) an obligation to stand ready to undertake an enforceable obligation to provide specified goods or services; and
 - (c) if the transferee would be required to return part or all of the consideration to the extent of any non-performance, an obligation to stand ready to undertake a return obligation.
20. The reasoning for this view is that receipt of the transferred assets before the arrangement becomes binding leads to the following possible mutually exclusive outcomes, each of which requires an outflow of economic benefits:
 - (a) the arrangement does not become binding and the transferred assets must be returned to the transferor; or
 - (b) the arrangement becomes binding and, for each promised good or service, either:

- (i) the entity provides the stipulated good or service; or
 - (ii) consideration is returned to the transferor due to non-performance of the promise to provide the good or service (but if a return obligation would not arise when the arrangement becomes binding, it should be assumed that performance of the enforceable promise would definitely occur).
21. Staff thinks the ‘advance receipt’ liability should be measured by summing the measures of the stand-ready obligations described in paragraph 19. Each of those stand-ready obligations should be measured as the product of the probability of occurrence of the outflow and the amount of that outflow.
22. In AASB Agenda Paper 10.5 / FRSB Agenda Paper B7.5 and paragraph 8 of this paper, respectively, AASB staff recommend that:
- (a) all non-financial liabilities of PBEs/NFPs⁷ should be measured using the measurement attribute in IAS 37, which is based on the entity’s cost of performing its promises to provide goods or services (fulfilment value); and
 - (b) return obligations of PBEs/NFPs should be measured as the probability-weighted amount of consideration that the entity expects to refund to the customer.
23. In relation to non-financial liabilities, the measurement attribute in IAS 37 takes into account the probability of the outflow of economic benefits occurring. In relation to return obligations, using the measure in paragraph 22(b) would achieve the principle in paragraph 21, in relation to both:
- (a) the return of the transferred assets if the arrangement does not become binding; and
 - (b) the return of consideration to the extent of any non-performance of performance obligations if the arrangement becomes binding.
24. Paragraphs 22 – 23 indicate that applying the approach discussed in paragraphs 18 – 21 would use the same measurement principles as those proposed by staff for performance

⁷ (except those covered by another Standard such as IAS 19 *Employee Benefits*)

obligations and return obligations in the absence of advance receipts. Consequently, when an arrangement becomes binding and an 'advance receipt' no longer exists, the performance obligation and any return obligation would continue to be measured on the same basis. The only change would be that the probability of each outcome would change (because the probability of a return of assets due to a failure of the arrangement to become binding would become nil), and this would be reflected in the revised measure of each remaining obligation.

25. In contrast to the assumed fact pattern in the example in paragraph 18, consider circumstances in which:

- (a) the transferee would not be required to return assets if the arrangement did not become binding;⁸ or
- (b) the promises to provide goods or services that the transferee would make if the arrangement became binding would fail to qualify as a liability because they are either:
 - (i) insufficiently specific; or
 - (ii) not enforceable by legal or equivalent means.⁹

26. In the circumstances described in paragraph 25(a), the entity would not have a liability when the advance receipt is received, and the entire amount of the transaction would be recognised as income immediately. At that date, the entity would not be presently obliged to either perform or return assets to the transferor.

27. In the circumstances described in paragraph 25(b), the entity would have neither:

⁸ The AASB and FRSB tentatively decided in December 2010 that 'advance receipts' give rise to liabilities only if a future sacrifice of economic benefits is required if the specified future event (the taxable event occurring or the arrangement becoming binding) does not occur.

⁹ The AASB and FRSB tentatively decided in October 2010 that a promise to provide goods or services is a performance obligation [liability] if: (1) it involves a sufficiently specific stipulation regarding the entity's promised performance; and (2) it is enforceable (i.e., the transferor is capable of enforcing the promise by legal or equivalent means).

- (a) an obligation to stand ready to undertake an enforceable obligation to provide specified goods or services; nor
- (b) an obligation to stand ready to undertake a return obligation.

However, if the entity would be required to return assets if the arrangement did not become binding, it would still have an obligation to stand ready to make that return. The assessed probability of the arrangement failing to become binding would determine the initial carrying amount of that liability and, consequently, the proportion of the transaction amount that would be recognised immediately as income.

28. Staff think the differences between the outcomes described in paragraphs 21 – 23 and 26 – 27 are appropriate, because the economic substance of the different transactions is significantly different.

Advance Receipts from Taxes

29. In developing ED 180/ED 118, the Boards discussed whether some taxes may give rise to performance obligations and return obligations (e.g., in respect of special purpose levies), and decided not to provide guidance on that issue (i.e., general principles would apply). Staff think that, if particular taxes do give rise to performance obligations and return obligations, those obligations would arise upon receipt of the taxes. Unlike with transfers, the existence of any advance receipts does not delay the inception of those obligations. The creation of those obligations is not conditional on the taxing entity formally agreeing to promise to provide the goods, services and right of return. Therefore, the stand-ready obligations referred to in paragraph 19(b) and (c) in relation to advance receipts of transfers would not arise.
30. Similarly to advance receipts of transfers, advance receipts of taxes would give rise to an obligation to stand ready to return the transferred assets (taxes paid in advance) if the taxable event does not occur. Consistent with the staff proposal in paragraph 8 for the measurement of any return obligation, and the more specific proposals in paragraphs 21 – 22 for measuring advance receipts of transfers, staff proposes that this stand-ready obligation should be measured as the probability-weighted amount of

consideration that the entity expects to refund to the taxpayer. If the probability of refund is low (i.e., the taxable event is highly likely to occur), and there are no performance obligations and related return obligations in respect of the tax, most of the tax received in advance of the taxable event occurring would be recognised as income immediately. In such cases, this outcome would differ from that proposed in ED 180/ED 118, where tax income is recognised only when the taxable event occurs.

31. Staff think it would generally be unusual for advance receipts of taxes to occur in Australia or New Zealand. (For example, in contrast to the fact pattern in Example 8 in the Illustrative Guidance in IPSAS 23, provisional tax is not payable in the period preceding the tax year.) And where they occur, they might often be immaterial—in which case, there would be no need to perform complex assessments of the probability of a return occurring. Nevertheless, this paper discusses the principles that should be applied to their measurement, for consistency with the scope of IPSAS 23 and to ensure the model is robust enough to deal appropriately with different forms of return obligations.

Staff recommendations

32. Depending on the circumstances, a transferee's obligations arising from the receipt of assets before the transfer agreement becomes binding may comprise:
- (a) an obligation to stand ready to return the transferred assets (or pay equivalent compensation) if the arrangement does not become binding;
 - (b) an obligation to stand ready to undertake an enforceable obligation to provide specified goods or services; and
 - (c) if the transferee would be required to return part or all of the consideration to the extent of any non-performance, an obligation to stand ready to undertake a return obligation.
33. Each of the stand-ready obligations identified in paragraph 32 should be measured as the product of the probability of occurrence of each possible outflow and the amount of that outflow. The stand-ready obligations referred to in paragraph 32(a) and (c) are return

obligations and thus should be measured at the probability-weighted amount of consideration that the entity expects to refund to the transferor. The stand-ready obligation referred to in paragraph 32(b) is not a return obligation and should be measured using the measurement attribute in IAS 37, which is based on the entity's cost of performing its promises to provide goods or services (fulfilment value) and reflects the probability of the outflow occurring.

34. When the arrangement becomes binding, the stand-ready obligations described in paragraph 32(b) and (c) would be replaced with performance obligations and return obligations.
35. With advance receipts of taxes, the stand-ready obligations described in paragraph 32(b) and (c) would not arise. However, unlike with advance receipts of transfers, transactions giving rise to advance receipts of taxes may give rise to performance obligations and accompanying return obligations.
36. Advance receipts of taxes give rise to an obligation to stand ready to return the taxes paid in advance if the taxable event does not occur. This stand-ready obligation should be measured as the probability-weighted amount of consideration that the entity expects to refund to the taxpayer.

Questions for Board members

- Q2** Do you agree with the staff recommendations regarding the nature of the obligations that may arise from advance receipts of transfers and taxes, as set out in paragraphs 32 and 34 – 36?
- Q3** Do you agree that all stand-ready obligations arising in respect of advance receipts of transfers or taxes should be measured as the product of the probability of occurrence of each possible outflow and the amount of that outflow? Specifically, do you agree that:
- (a) stand-ready obligations to return assets to the transferor or taxpayer should be measured at the probability-weighted amount of consideration that the entity expects to refund? and

- (b) in relation to advance receipts of transfers, obligations to stand ready to undertake an enforceable obligation to provide specified goods or services should be measured using the measurement attribute in IAS 37?

Q4 If you disagree with these recommendations, please indicate how you think advance receipts should be measured. For example, do you think advance receipts should be measured on a different basis than return obligations?