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The Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Chairman

EXPOSURE DRAFT ED 144 “PROPOSED AUSTRALIAN GUIDANCE TO ACCOMPANY AASB 1004 CONTRIBUTIONS”

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attached comments in response to the Exposure Draft referred to above.

This represents the views of the Australian members of ACAG with the exception of the Auditor-General for South Australia who reserves his right to respond separately to auditing and accounting Exposure Drafts where he deems it appropriate, rather than as a member of ACAG.

Request for Comments

While overall ACAG supports the concepts outlined in the proposed guidance material, we believe that it would be more appropriate for the standard to be redrafted instead of simply adding the proposed guidance. In addition, we are concerned as to the timing of the issuance of the proposed guidance and the AASB’s intention to have the proposed guidance applied to reporting periods beginning on or after 1 January 2005. We have enclosed as a separate attachment, commenting on specific matters for consideration by the AASB prior to it finalising this exposure draft.

Thank you for providing the members of ACAG with the opportunity to comment.

Yours faithfully



MIKE BLAKE
CHAIRPERSON
ACAG FINANCIAL REPORTING GROUP
5 December 2005

SUBMISSION BY THE AUSTRALIAN MEMBERS (EXCEPT FOR THE AUDITOR-GENERAL FOR SOUTH AUSTRALIA) OF THE AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL ON EXPOSURE DRAFT ED 144 “PROPOSED AUSTRALIAN GUIDANCE TO ACCOMPANY AASB 1004 CONTRIBUTIONS”

Specific Matters for Consideration by the AASB

- (a) whether guidance should be issued at this stage to accompany AASB 1004, in light of the likelihood of future changes given the various projects being undertaken by the IASB and IPSASB;**

Overall comments

While we do not have any significant objections regarding the concepts outlined in the proposed guidance material, we believe that it would be more appropriate for the standard to be redrafted instead of simply adding the proposed guidance.

We note the preface of the exposure draft states that:

“the requirements in AASB 1004 are broadly consistent with the requirements under pre-2005 Australian Accounting Standards. However, there has been a re-interpretation of the requirements in AASB 1004.... that results in some types of contributions that were previously initially recognised as revenue being initially recognised as a liability.”

We have some concern with requiring a change to the way an accounting standard is being applied through a “re-interpretation” of the standard without any changes to the standard itself. The need for the standard to be “re-interpreted” may in itself suggest the requirements of the standards are not sufficiently clear as they presently stand. Further, the fact that this re-interpretation is based on another exposure draft suggests it may be more appropriate to revise the existing standard AASB 1004.

In our opinion, guidance material should be limited to providing commentary and examples to further explain the concepts and requirements outlined in the standard. In this instance the proposed guidance appears to go beyond merely providing such commentary and examples and covers fundamental concepts and requirements not introduced within the actual standard. This distinction is particularly important given that the guidance material does not actually form part of the standard.

Examples of concepts and requirements not already covered within the standard include the treatment of contributions with components, treatment of contributions with stipulations and conditions, and the treatment of involuntary transfers. We believe such fundamental concepts and requirements should be documented within the actual standard instead of being part of the guidance material. Furthermore, we believe that existing paragraphs 11 and 12 of the standard may be more appropriately included in the guidance material as these paragraphs basically provide illustrative examples on determining whether transactions are to be recognised as contributions.

While we acknowledge the intention of proposed guidance is to be an interim measure, the fact remains that AASB 1004 is an existing standard applicable for reporting periods commencing on or after 1 January 2005. While changes may be required to AASB 1004 at a later date following the release by the IPSASB on an international standard on non-exchange revenue and its subsequent review by the AASB, the AASB should be aiming to ensure that the existing standard is clear and can be applied consistently. For this reason we believe that it may be appropriate to consider reviewing the existing AASB 1004 to ensure that its requirements are clear and that it includes all relevant concepts to be applied with sufficient guidance to assist in its application.

Application date

We are concerned as to the timing of the issuance of the proposed guidance and the AASB's intention to have the proposed guidance applied to reporting periods beginning on or after 1 January 2005.

Firstly, there are inconsistencies between the proposed guidance and the requirements of AAS 27 *Financial Reporting by Local Government*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments*. AASs 27, 29 and 31 require contributions to be recognised as revenues when the government department/council obtains control over them, irrespective of whether conditions are imposed on the use of the contributions. Furthermore, the standards state that transfers to an entity only give rise to a liability where the transfers are reciprocal. This would preclude governments from recognising a liability when contributions are received as contributions are non-reciprocal in nature, and as a result, this will lead to inconsistent accounting treatments between not-for-profit entities that apply AASB 1004 and government entities that apply AASs 27, 29 and 31.

We acknowledge that the AASB intends to withdraw the three government standards and replace the guidance that existed in those standards with the proposed guidance. However, for consistency purposes, we believe that any changes to the requirements of AASB 1004 should be implemented only once AAS 27, AAS 29 and AAS 31 have been withdrawn.

Secondly, applying the proposed guidance for reporting periods beginning on or after 1 January 2005 will have an impact on entities that have a December year-end reporting period. As the changes have to be applied retrospectively, we believe that entities should be given sufficient time and notice to implement the change in policy.

Transitional Arrangements

We are unsure of how this "re-interpretation" is expected to be treated and disclosed in the first financial statements prepared under Australian equivalents to International Financial Reporting Standards (AIFRS). Specifically, we are unsure of whether this should be treated as a change in accounting policy that is within the scope of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* or whether it should fall within the exemption provided under paragraph 42 of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* as a change in accounting policy that occurs as a result of the adoption of AIFRS.

The statement contained in the AASB's media release that "ED 144 does not propose any changes to the requirements of AASB 1004" seems to suggest that the change in accounting

policy is not a result of adoption of AIFRS. We further note that “Australian equivalents to IFRSs” is defined in AASB 1 as:

“accounting standards issued by the Australian Accounting Standards Board that are equivalent to Standards issued by the International Account Standards Board (IASB), being AASBs 1-99 corresponding to the IFRS series and AASBs 101-199 corresponding to the IAS series.”

This definition would preclude changes in accounting policy as a result of re-interpretations of AASB 1004 to fall within the exemption provided under AASB 1. This led us to believe that changes in accounting policies as a result of the re-interpretation of AASB 1004 would fall within the scope of AASB 108 and would therefore require entities to make the relevant disclosures required by AASB 108. The inclusion of some guidance or transitional provisions on this issue is recommended. We note, however, that from an accounting perspective, the treatment would be the same regardless of whether AASB 1 or AASB 108 applies, as entities will be required to apply the change in accounting policies retrospectively.

(b) the usefulness of the proposed guidance on the circumstances in which a contribution is initially recognised as a liability, rather than income;

We do not have any concerns with the proposed guidance on the circumstances in which a contribution is initially recognised as a liability.

(c) whether there are any situations that would result in the guidance leading to a liability being initially recognised, when it is more appropriate for income to be recognised;

We are not aware of any such situations.

(d) whether there are any situations that would result in the guidance leading to income being initially recognised, when it is more appropriate for a liability to be recognised;

We are not aware of any such situations.

(e) whether the distinction between applying AASB 118 and AASB 1004 is sufficiently clear; and

Distinction between the application of AASB 118 and AASB 1004

We believe that the distinction between a contribution and revenue under AASB 118 is not clear. Paragraph G1 of the guidance proposes that “when amounts received or receivable relate to the rendering of services they are accounted for in accordance with AASB 118 *Revenue* (or AASB 111 *Construction Contracts*), but only if they are not contributions”. This could be interpreted as there being two types of contributions, namely, contributions that are not related to rendering of services and those that are related to the rendering of services. Paragraph G1 suggests that both types of contributions are required to be treated in accordance with AASB 1004. However, this is inconsistent with the flow chart in G5 and the commentary in paragraph G7, which states that “[a]s noted in paragraph G1, any amounts received or receivable that relate to the rendering of services are accounted for in

accordance with AASB 118”, regardless of whether they satisfy the definition of contributions under AASB 1004.

Accordingly, we believe that the guidance should be revised to clearly reflect the AASB’s intention on this issue. Refer to (f) for further comments.

Concept of reciprocity

From the definitions, it appears that what distinguishes contributions from other transfers is whether the transfer is reciprocal. However, from a public sector perspective, it is often difficult to assess whether the grants received and services performed are reciprocal and practitioners have always struggled with the concept of reciprocity.

An example of this is research grants received by universities from the government. One might conclude that the grants provided are not of approximately equal value to the benefits received from the results of the research, but this is very much a judgemental call. There is also a question of whether the grantor directly receives the benefits of the research, although one might argue that the benefits received is the cost that the grantor would have had to incur if they had the relevant expertise.

Accordingly, we believe that any proposed guidance should also address or further refine the concept of reciprocity to assist preparers in determining whether AASB 118 or AASB 1004 should be applied.

(f) whether, instead of treating contributions in relation to the rendering of services under AASB 1004 and using the proposed guidance, such amounts should be treated in accordance with the rendering of services requirements in AASB 118.

We believe that contributions relating to the rendering of services should be accounted for in accordance with AASB 1004 using the proposed guidance, rather than AASB 118.

As an example, the government provides funding to government departments via annual appropriations. As government departments are the administrative arms of a government, the annual appropriations could be viewed as contributions that relates to the rendering of services. If the requirements of AASB 118 are adopted, it would create a fundamental shift from the current practice. We believe that it would be more appropriate for the current principles to continue, as departments only have a fiduciary responsibility in relation to the deployment of those contributed assets and this fiduciary responsibility should not result in a liability being recognised by the government department. The same principles should apply for multi-year grants.

We believe that the requirements of AASB 118 should only apply where there is a reciprocal agreement in place, where the grantor directly receives benefits of approximately equal value to the assets provided. This emphasises the need for further refinement on the concept of reciprocity to assist preparers in determining whether AASB 118 or AASB 1004 should be applied.

In addition, we acknowledge that the appendix to AASB 118 provides examples of circumstances that are rendering of services and guidance to determine the timing of revenue recognition. However, these examples are developed with for-profit entities in mind and we recommend that further examples be developed for public sector entities.