ED 147 sub 6

AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

PO Box 275, Civic Square, ACT 2608 Australia
Phone & fax 1800 644102
Overseas: Phone & fax +61 2 9262 5876
E-mail: john.rosier@audit.nsw.gov.au
ABN 13 922 704 402

Professor David Boymal
ChairmanAustralian Accounting Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 8007
AUSTRALIA

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Dear Professor Boymal

ED 147 - REVENUE FROM NON-EXCHANGE TRANSACTIONS (INCLUDING TAXES AND TRANSFERS)

The members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attached comments in response to the Exposure Draft ED147, *Revenue from Non-Exchange Transactions*.

The views expressed in the attachment to this submission represent those of all 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.

The opportunity to comment is appreciated and I trust the Board will find our comments useful.

Yours faithfully

Frank McGuiness
Chairman
ACAG Financial Reporting Group

Attachment to ACAG Comment on ED 147

ED 147 Revenue from Non-Exchange Transactions (Including Taxes and Transfers)

ACAG congratulates the AASB on the release of ED 147, and regards the reporting of non-exchange transaction revenues as an extremely important aspect of accountability within the public sector. The ED deals with issues that need to be considered in recognising and measuring revenue from non-exchange transactions, including the identification of contributions from owners.

ACAG has reviewed the Exposure Draft, including each of the significant proposals in ED 147, and has provided both general comments and comments on the specific matters raised.

Specific matters for comment:

(1) Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to implementation by not-for-profit entities in the private sector? (ED 147)

No issues are raised.

(2) Are the proposals in the best interests of the Australian economy? (ED 147)

The proposals are sound, logical and will be in the best interests of the Australian economy as they will provide users with a comprehensive standard that deals with non-exchange transactions.

The IPSASB (ED 29) would value comments on the proposals to:

a) Exclude entity combinations that are non-exchange transactions from the scope of the Standard (see paragraph 2).

ACAG supports the exclusion of entity combinations from the scope of the proposed standard.

b) Include within the scope of the IPSAS compulsory contributions to social security schemes (e.g. health and disability insurance, aged pensions) which are in the nature of non-exchange transactions. In particular:

i. Do you think that these compulsory contributions to social security schemes should be explicitly excluded from the scope?

We support the inclusion of compulsory contributions of a non-exchange nature to social security schemes in the scope of the

Standard. However it is not clear within the Standard that it applies to compulsory contributions to social security schemes, as there is no mention of them in the Standard, except in BC27.

ii. **Do you think that the ED gives enough guidance in respect of such compulsory contributions? If not, do you think the IPSAS should explicitly address these compulsory contributions and provide specific guidance to assist entities determine to what extent such contributions should be considered as exchange transactions? (See paragraph BC27)**

ACAG are of the view that the proposed guidance contained within BC 27 is not adequate and therefore, request additional guidance to be inserted. However, we realise that this could prove difficult due to the different jurisdictional requirements. We recommend guidance on the identification of social security schemes; why they are considered non-exchange transactions; and principles of recognition and treatment to ensure consistency in interpretation and accounting treatment.

c) **Define terms as set out in paragraph 8. These definitions have been developed by the IPSASB for this IPSAS. Please identify any amendments to the definitions that you consider necessary.**

Proposed definitions are supported. However, further consideration is required on the definition of "revenue" because the IASB and AASB frameworks use the term "income" instead, with revenue being a sub-set of income.

d) **Distinguish exchange and non-exchange components of non-exchange transactions. Paragraphs 11 and 12 note that these transactions may comprise two components, one of which is an exchange transaction, each component of which is recognised separately.**

Proposals supported. However the guidance in paragraphs 11, 12 and 44 is too vague on how to recognise the two components. We understand that it is covered in the example IG30, however, believe it is more appropriate to outline the recognition principles within paragraph 44.

e) **Include guidance to clarify that restrictions do not give rise to the recognition of a liability on initial recognition of the transferred asset (paragraph 20). Do you agree that restrictions do not give rise to liabilities on initial recognition of the transferred asset?**

We agree that restrictions do not give rise to liabilities on initial recognition of the transferred asset.
However, we recommend additional guidance be inserted to clarify the differentiation between restrictions, conditions and stipulations (in addition to the definitions provided) and their respective accounting treatments.

f) **Require recognition of assets when resources are transferred or when the reporting entity has an enforceable claim to resources that are to be transferred (see paragraphs 33-34 and paragraph 80). The ED notes that before a claim to a**

resource is enforceable, the resource does not meet the definition of “control of an asset” because the recipient reporting entity cannot exclude or regulate the access of the transferor to the resource.

Proposals supported.

g) **Measure assets acquired in a non-exchange transaction at their fair value on initial recognition and amend IPSAS 12, “Inventories”, IPSAS 16, “Investment Property” and IPSAS 17, “Property, Plant and Equipment” to be consistent with this requirement (see paragraphs 38-39 and the Appendix). IPSASs 16 and 17 currently require that where assets are acquired for no cost or a nominal cost, their cost is their fair value as at the date of acquisition.**

Proposals supported.

h) **Require that a liability be recognised in respect of an asset transferred subject to conditions upon initial recognition of the transferred asset (paragraph 50). When the condition has been satisfied the liability is reduced, or derecognised, and revenue recognised. Alternatively, do you consider that the IPSAS should only require the recognition of a liability when it is more likely than not that the condition will not be satisfied (see paragraphs BC11)? In addition, are you of the view that the requirements relating to the recognition of a liability in respect of a condition applies equally to depreciable and non-depreciable assets?**

The proposals contained within paragraphs 45 and 50 are supported.
ACAG does not support the recognition of a liability, when it is more likely than not that the condition will not be satisfied because entities would recognise the revenue element ahead of time, notwithstanding the outflow of resources necessary to satisfy the condition.
We are of the view that the requirements relating to the recognition of a liability in respect of a condition do in fact apply equally to depreciable and non-depreciable assets.

i) **Require liabilities related to inflows of resources to be measured according to the requirements of IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” (paragraph 52).**

Proposal supported as it will ensure consistency with regards to measurement of liabilities.

j) **Require a non-exchange transaction that gives rise to the recognition of an asset to also give rise to the recognition of revenue to the extent that a liability is not recognised (paragraph 54). Are there any non-exchange transactions in which it would be appropriate to initially recognise the gross inflow of economic benefits or service potential represented by the assets as revenue even if a liability is also recognised, with the simultaneous recognition of an expense for the liability?**

Proposals supported. We could not identify any non-exchange transactions that would be more appropriate to initially recognise as revenue, with a simultaneous expense for the liability.

k) **Require a reporting entity to recognise liabilities in respect of advance receipts related to taxes (see paragraph 67) and advance receipts related to transfers (see paragraph 105).**

Proposals supported.

l) **Not permit the netting of expenses paid through the tax system (see paragraphs 72-76) against taxation revenue. Instead, such expenses must be recognised separately on a gross basis. The ED distinguishes between expenses paid through the tax system and tax expenditures, and notes that tax expenditures are foregone revenue, not expenses.**

Proposals supported.

m) **Permit recognition of services in-kind that satisfy the recognition requirements (see paragraphs 99-103) and require disclosure of the nature and type of services in-kind received, whether recognised or not (paragraphs 107-108).**

While the proposals are supported in principle, paragraph 99 states, “An entity may, but is not required to, recognise services in-kind as revenue and as an asset”. This black letter requirement is poorly written and does not appropriately address when services in-kind can be recognised.

The recognition requirements of an asset need to be incorporated within the black letter paragraph, stating that services in-kind shall be recognised as revenue and as an asset, if it meets the recognition criteria and definition of an asset.

n) **Provide entities a five year period, in which to conform their accounting policies in respect of taxation revenue to the requirements of this Standard (see paragraphs 115-122). Do you believe that transitional provisions should be provided in respect of other non-exchange transactions?**

The ED assumes that reliable measurement of taxation revenue will always be achievable and therefore proposes in the transition to this situation that a government can continue with its existing tax policies until the expiry of the proposed 5-year transition, after which time the presumed available reliable method of estimation of taxation revenue is to be applied to capture the tax earned from the taxable event.

While ACAG supports the use of full accruals for taxation revenue where reliable measurement is possible, the reliability of estimation should be considered in the particular context at hand. Judgement about the reliability of measures of taxation revenue should not be pre-empted by the proposed Standard.

It follows that the Standard should specify a ‘fall back’ position for situations where a reliable measure cannot be obtained.

<u>Other matters:</u>

- Even though paragraphs 33-34 discuss the concept of controlling an asset, ACAG recommends that the following criteria should be added to paragraph 31, in relation to the recognition of assets:

  Paragraph 31 (c) – *"The entity obtains control of the contribution or the right to receive the contribution"*

- ACAG also recommends that the following be inserted into paragraph 106, in relation to disclosures:

  Paragraph 106 (f) – *"The amount of liabilities forgiven"*

- Paragraph 13 covers revenue collected as an agent of government or another government organisation. Clarification is required on whether this means 'administered activities' (as per AAS 29).

- Fair value is defined within the Standard, however additional guidance is required on the determination of fair value. In the public sector, there are often instances where fair value is difficult to ascertain because of the absence of an active market. Guidance on how to determine fair value would be very useful.

- Example 13 on research grants provides an instance where a research grant received by a university is considered an exchange transaction. However, from a public sector perspective, it is often difficult to assess whether the grants received and services performed are reciprocal/exchange transactions and practitioners have always struggled with the concept of reciprocality.

  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 proposed guidance should be included in the Standard to refine the concept of reciprocality and how this Standard relates to AASB 118 or AASB 1004.

- Paragraph 62 - We support the approach in paragraph 62 that taxation revenue only arises for the government that imposes the sales tax and not for other entities. The exercise of a taxing power will be discretion of the taxing government. Disposition of the tax to other governments is a separate transaction.

  However, the obligation to pass the tax to the States should give rise to a liability and an expense in the first instance, with the liability being settled by the transfer of the proceeds to the States. In its current form, paragraph 62 simply says that settlement results in a decrease in an asset, with no mention of reducing the liability.