

20 October 2016

Australian Accounting Standards Board
PO Box 204
Collins St West
VIC 8007
Australia

Dear Sir/Madam,

RE: SUBMISSION TO AASB – FATAL-FLAW REVIEW DRAFTS

I provide my comments in relation to the AASB Fatal-Flaw Review Draft of the AASB 10XX Income for Not-For-Profit Entities.

My comments are specific in relation to Example 12: *Refund of prepaid local government rates* as the subject matter affects the audits of several local governments in Western Australia that I am auditing.

Yours faithfully



MIT GUDKA
REGISTERED COMPANY AUDITOR

SUBMISSION

AASB Standard 10XX

Income of Not-for-Profit Entities

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PARTNERS

Certified Practising Accountants



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Background

On 12 August 2016, I raised the following query with the AASB in respect of accounting for Council rates received by local governments as income in advance or revenue for current year.

As a registered company auditor, I was noting fundamental income recognition issues of Accounting Standard AASB 1004 *Contributions* for the not-for-profit local government sector.

BACKGROUND

A local government raises Council rates for the 2017 financial year on 15 July 2016. Many ratepayers may choose to pay the rates in advance to the local government before 30 June 2016. The amounts received in advance are material to the financial statements of the local government.

For the purposes of the financial statements for 30 June 2016, the local government wishes to treat the rates received in advance as a current liability (Income in advance). The reasoning behind this is that "these payments made by ratepayers can be refunded if requested to the local government at any time or if a property is sold, the local government would refund the original payer the advance amount. The local government considers itself just the caretaker until it raises the rates for the following year and then offsets these advance payments against the rates as per the ratepayers request or refund if they so wish. Because this is subjective, it does not view it as income earned. It does not believe control of assets 'upon the receipt of the rates' is applicable until the rates have been raised."

ACCOUNTING STANDARD

Accounting Standard AASB 1004 paragraph 30 which clearly states that:

"Control over assets acquired from involuntary non-reciprocal transfers, such as rates, taxes and fines, is obtained when the underlying transaction or other event giving rise to control of the future economic benefits occurs. For example, taxes are recognised when the underlying transaction or event that gives rise to the GGS's or whole of government's right to collect the tax occurs and can be measured reliably. In some cases, an inability to reliably measure taxes when the underlying transactions or events occur means that they may need to be recognised at a later time. In most cases, taxes will be recognised in the reporting period in which the tax assessments are due to be issued or during which the tax collections are received. For this reason, the disclosure of policies adopted for recognising taxes will enhance the understandability and comparability of information relating to them. Where the transfers arise from a periodical charge, such as a land tax, a government obtains control over the assets on the day on which the government becomes entitled to levy the land tax.

Control over assets acquired from local government rates would be obtained at the commencement of the rating period or, where earlier, upon receipt."

QUERY

There appears to be confusion amongst local governments for the timing of when to recognise local government rates received in advance as revenue based on the accounting standard paragraph and the matching of revenue to the correct accounting period i.e. June 2016 which relate to rates for the 2016 financial year.

I will appreciate a formal response on the AASB's view and clarification on the above matter.

Introduction

My review of the AASB Standard 10XX shows and supports the notion that the standard appears to clarify and simplify the income recognition requirements that apply to not-for-profit (NFP) entities, previously in AASB 1004 *Contributions*.

Of particular interest in my work as a local government auditor involved in audits of several local governments in WA is Example 12 in the AASB Standard 10XX.

Example 12: Refund of prepaid local government rates

Local Council A calculates the rates it charges local residents on an annual basis approximately two months prior to the annual period to which the rates relate. Residents and other ratepayers are able to pay their rates in advance on a quarterly or annual basis. Rate payments received before the annual rateable period begins are fully refundable up to the beginning of the rateable period for which the payment is made.

For example, if the Council receives a payment in May 20X6 for the rateable period from 1 July 20X6 to 30 June 20X7, the receipt is refundable in May and June 20X6. During the refundable period, the rates received in advance meet the definition of a financial liability under AASB 132 and are within the scope of AASB 9. Following the taxable event on 1 July 20X6 the financial liability is extinguished.

Based on the above example, it is noted that rates levied by a local government apply for the 20X7 year. Any ratepayer who has paid rates in advance prior to 30 June 20X6 would need to be refunded their rates if they chose to request their refunds from the local government.

Analysis

When identifying the factors which are necessary to establish that there is control and reliable measurement, it would be necessary to look at the specific legislation and wording of the raising of each rate.

Control

With the situations I have looked at in past years, the raising of the rate notice applicable for the 20X7 year (event which results in control of the known amount) was a necessary element to create the liability attaching to a property.

However, this liability applies at the commencement of the 20X7 financial year. At that time, the local government has a receivable, irrespective of who owns the property. Therefore, the fact that a refund from the local government may be made to an advance payer effects income recognition on 1 July, as evidenced by the rates adjustment found in rates notices/property settlement notices.

Reliable Measurement

The reliable measurement criterion provides a supporting argument for waiting until the rate is struck and rate notices are raised to recognise rate income. The passing resolution of councillors or equivalent is when the amount of rates per property is known.

ED260 Income for Not-For-Profit Entities

The AASB released an exposure draft – ED260 Income for Not-For-Profit Entities – which proposes to better match income with expenditures in future (likely to be the 2018/19 financial year if the ED becomes an Accounting Standard).

The timing of income recognition depends on whether a transaction gives rise to a liability or other performance obligation (a promise to transfer a good or service) related to an asset (such as cash or another asset) received by an entity.

AASB 10XX Paragraph B26 states that taxes, rates and fines do not give rise to a contract liability or revenue recognised in accordance with AASB 15, even when they are raised in respect of specific goods or services. This is because the entity does not promise to provide goods or services in an agreement that creates obligations enforceable against the entity by legal or equivalent means.

Based on the ED260, the consideration is whether the transferred asset gives rise to a performance obligation under a contract with a customer i.e. do the rates received in advance give rise to a performance obligation to a local government (i.e. incur operating and capital expenditure for the benefit of ratepayers?). My view is that it does not satisfy this criterion. If a local government chose not to incur all their budgeted operating and capital expenditure in a year, ratepayers cannot ask for a refund of their rates. Therefore local governments cannot apply AASB 15 *Revenue from Contracts with Customers*, with the consideration allocated to performance obligations.

Conclusion

Legal Enforceability

I do not think that it prevents recognition of a liability for rates received ahead of 30 June 20X6. This is because, from the perspective of legal enforceability, local governments must refund any rates received in advance upto 30 June 20X6. Therefore, control over assets acquired from local government rates would be obtained at the commencement of the rating period.

Other Research

After conducting my research with the Department of Local Government and Communities in Western Australia recently, I was advised that there was nothing in the local government legislation which required a local government to refund rates to a ratepayer; if a request was received.

However; my view is that under common law provisions, any advance payments made by ratepayers to local governments as explained above would need to be refunded by the respective local governments if rate notices have not been raised. This is generally the norm under common law (e.g. an advance payment to a mobile phone services company can be requested back by the payer if no phone bill has been raised by the payee, etc.).

All local governments I have interviewed have indicated that they are obliged to refund monies received in advance for local government rates.

In conclusion:

The timing of when the rate notices are issued (i.e. 1 July 20X6) for the 20X7 financial year illustrates that revenue should be recognised from that point.

Any earlier payments (rates received in advance) would have to be refunded under common law and hence treated as a financial liability at 30 June 20X6.

About the Author

	<p>Background</p> <p>Mit is the Manager – Audit & Assurance in the firm with over 10 years of practical experience in all facets of auditing and financial reporting services.</p> <p>Mit was recently acknowledged in February 2016 as a contributor of CPA Australia's 2016 <i>Guide to the Valuation and Depreciation of Public Sector Assets</i>.</p>
<p>MIT GUDKA AUDIT & ASSURANCE Registered Company Auditor (No: 474860)</p>	<p>Professional and Industry Experience</p> <ul style="list-style-type: none"> ■ Mit has exceptional technical skills and obtained considerable experience in providing audit services to varied client base, ranging from not-for-profit organisations to large private and listed/unlisted public companies (financial services, manufacturing, minerals trading, freight forwarding, etc.), aged care associations, trust accounts for estate agents, solicitors and settlement agents, local government authorities and state government bodies.
<p>Function and Specialisation</p> <ul style="list-style-type: none"> ■ Audit and Assurance Services ■ Financial Reporting and Accounting 	<ul style="list-style-type: none"> ■ The scope of such experience includes Financial External Audits, Internal Audits, Financial Management Reviews, Fraud Investigations, Compliance Audits and Grant Acquittals.
<p>Professional Associations</p> <p>Memberships of professional bodies include:</p> <ul style="list-style-type: none"> ■ Member of the Institute of Chartered Accountants Australia 	<ul style="list-style-type: none"> ■ Mit is well qualified and has been extensively involved in Local Government audits and reviews. He has a sound understanding of the provisions of the Local Government Act and Regulations under that Act in Western Australia.
<p>Education</p> <p>Mit's formal qualifications are:</p> <ul style="list-style-type: none"> ■ Graduate Diploma of Chartered Accounting (Australia) ■ Bachelor of Commerce (Curtin University of Technology, Western Australia) ■ Diploma of Business (Perth Institute of Business and Technology) 	<ul style="list-style-type: none"> ■ He is actively involved in most of the significant and complex audits for which the firm is responsible. This has enabled him to develop a detailed working knowledge of operations and the industry as a whole.
<p>Licenses & Certifications</p> <p>Mit holds the following registration:</p> <ul style="list-style-type: none"> ■ Registered Company Auditor (ASIC) ■ Chartered Accountant (Australia) 	<ul style="list-style-type: none"> ■ Throughout his career, he has taken particular interest in the continually changing area of accounting and auditing standards and how this affects the firm's clients. Mit sets himself a high standard in delivering quality audits for all audit clients he manages for the firm, likes to provide practical and innovative solutions to complex problems, and enjoys fostering cooperation across a broad range of stakeholders. ■ He was also the past President of the Noranda Toastmasters Club, a member of Toastmasters International. Toastmasters International, founded in 1924, is regarded as the world's leading organisation dedicated to communication and leadership skill development. He won several awards in communication and leadership programs during his tenure with the organisation.

About Macri Partners



Macri Partners is a mid-tiered boutique accounting firm with its origins from 1969 in Perth, Western Australia.

Macri Partners provides an extensive range of audit and financial reporting services to a varied client base, ranging from small not-for-profit (NFP) organisations to private and public unlisted companies, Local Government Authorities, shopping centres, partnerships, superannuation funds and trusts. Our goal is to deliver the most up to date, progressive and accurate professional advice to our clients.

Our firm has a commitment to industry specialisation and to keeping informed of the latest techniques, legislation and other service opportunities. Charities and community service organisations, local governments, religious institutions, and health and aged care are where we specialise and are a significant segment of our Public Sector practice.

Our audit and assurance team has over 100 years combined experience in the audits of NFP organisations (including public sector bodies) in Western Australia.

Macri Partners have offered a significant range of services to Local Governments in Western Australia (WA) with the firm being the leader in WA for providing audit and other services to over twenty (20) Metropolitan Local Government Authorities out of the twenty nine (29) existing in the last few years. Some of these Local Government Authorities have also received varying levels of assistance with the preparation of statutory budgets and financial reports.

Our additional services include:

- Audit & Assurance Services
- Accounting & Taxation Services
- Investigations
- Management Consulting

Contacts

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