

SH/ cr: 051129 ED144

29 November 2005

Mr David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Mr Boymal

ED 144: PROPOSED AUSTRALIAN GUIDANCE TO ACCOMPANY AASB 1004 CONTRIBUTIONS

We write in response to the request for comments contained in Exposure Draft 144 *Proposed Australian Guidance to accompany AASB 1004 Contributions* ("ED 144").

Overall, we support the publication of guidance for not-for-profit entities in regard to the revenue recognition policy for contributions.

We have noted below a number of areas of general concern with the exposure draft and in addition we have responded to the specific matters for comment.

General comments

- We note that ED 144 includes an interpretation which results in a different revenue recognition policy from that documented in AASB 1004 (July 2004), since it provides more opportunity for entities to recognise a deferred liability in relation to amounts received. Yet as there is no change to the standard by implication the ED 144 interpretation suggests that the practice of recognising grant income on a receipts basis because an entity controlled the funds was incorrect. The guidance results in entities which have not applied previous AASB 1004 (July 2004) continuing to account for their contributions in the same manner, whereas those entities which applied AASB 1004 based on control now have to change accounting policy and have uncertainty regarding their 31 December 2005 results.
- The timeline for the publication of the guidance relating to this standard is very late and if it is going to be published, the timing should be accelerated to ensure that not-for-profit entities with 31 December year-ends, such as educational institutions, are notified of the correct interpretation of accounting treatment for their contributions to enable them to produce their first AIFRS financial statements on a timely basis without having to retrospectively apply the standard at 31 December 2006.

We note however, since it is the guidance to the standard which includes the re-interpretation, retrospective application may be a concern as the requirements in the standard have not been amended.

- The flowchart included at G5 in the exposure draft asks the following question: "Does the substance of the transaction relate to the rendering of services?", if the answer to this question is yes then the relevant standard for revenue recognition is AASB 118.

In our experience the majority of grants that are awarded by a Government department or agency require the provision of a service either back to the Government or to a particular sector of the community. In these circumstances ED 144 suggests that these grants are not a contribution and the monies received should be recognised as a deferred liability until spent.

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The only items likely to be classified as a contribution under ED 144 would therefore be items such as bequests or donations where the recipient does not have to repay the money.

- Contributions received are usually from a Government entity and grant agreements would normally contain a repayment clause which under the guidance in ED 144 would cause the contribution to be recognised as a deferred liability. We would like to confirm that the AASB anticipate that most grants would be recognised as a deferred liability.
- The Framework for the Preparation and Presentation of Financial Statements includes the definition of a liability and the following statement, "In assessing whether an item meets the definition of an asset, liability and equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form". Since many not-for-profit entities are reliant upon the funding received from Government or other sources, it is unlikely that they will not spend the money on the required project and therefore the probability of repayment of this money is low.

This would seem to indicate that the funds received would not meet the definition of a liability yet the new ED 144 seems to recommend recognition of unspent grant funds as a liability.

Specific matters for comment

- (a) **Should guidance 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?**

We believe that guidance is appropriate since the accounting treatment of contributions within the not-for-profit sector is currently inconsistent. However, the timing of this guidance is not necessarily appropriate, unless a definitive position can be arrived at prior to 31 December year-ends preparing their financial reports.

The AASB should ensure that they are heavily involved in the discussion process with the IASB and IPSASB to influence the decisions and try to encourage the future standards issued to be consistent with the guidance in AASB 1004 to avoid another change for not-for-profit entities.

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

Guidance provided is useful and clarifies the situation, however additional guidance should be included to confirm that grants from government are not expected to fall under the definition of a contribution, if this is the AASB expectation.

- (c) **Are there 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?**

See the response to (d) below.

- (d) **Are there 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?**

Prior to the guidance being issued, the majority of contributions would have been recognised as income, whereas not-for-profit entities are likely to prefer the treatment of recognising grants as deferred income.

Using the guidance in the framework as discussed above, the intention of a not-for-profit entity who receives funding is to spend the monies on the required purpose since the funds are normally intrinsic to their operations.

This would indicate that the entities control the funds and therefore the accounting treatment prior to issuing the guidance of revenue recognition on receipt would seem to be more appropriate.

(e) Is the distinction between apply AASB 118 and AASB 1004 sufficiently clear?

We understand that the distinction is that the grants awarded by Governments are not normally provided free of conditions and therefore these would appear to be recorded under AASB 118 whereas monies provided which do not require repayment, for example, donations would be accounted for under AASB 1004.

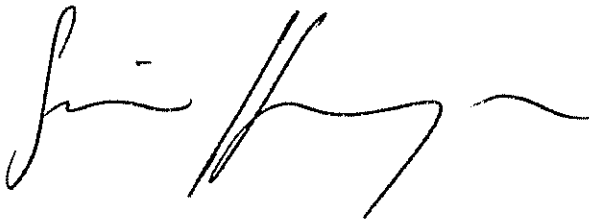
(f) Instead of treating contributions in relation to the rendering of services under AASB 1004 and using the proposed guidance, should such amounts be treated in accordance with the rendering of services requirements in AASB 118?

The guidance provided does not differentiate between the accounting treatment of a contribution where there is a stipulation under AASB 1004 and the treatment of rendering of services under AASB 118.

The definition of a contribution is where there is a non-reciprocal transfer, however the flowchart refers only to some services being provided without considering whether it is of equal value. We note that determining whether the services provided are approximately equal in value to the monies may be difficult.

Please contact Carmen Ridley (Carmen.ridley@williambuckvic.com.au) or myself (simon.hourigan@williambuckvic.com.au) via email or telephone on 03 8663 6000 if you wish to discuss further any matters arising from this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Hourigan', with a long horizontal flourish extending to the right.

Simon Hourigan
Director

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