UHY Haines Norton
Chartered Accountants

ED 147 sub 2

12 May 2006

The Chairman
Australian Accounting Standards Board
Level 4, 530 Collins Street
MELBOURNE VIC 3000

Dear Chairman,

Invitation to Comment on ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)"

We are pleased to submit our comments on Exposure Draft ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)". Our firm has a strong interest in the public, government and private not-for-profit sectors having provided external and internal audit services and consultancy for almost thirty years.

Overall Opinion

Our overall opinion is we support ED 147 in general. We agree with the AASB's position generally requiring the same accounting treatment for similar revenue transactions occurring in both for-profit and not-for-profit entities, including public sector entities.

We strongly support the proposal to recognise a liability for contributions when conditions exist in respect of the contributed assets, or when the contribution is in the nature of an advance receipt. We believe this accounting treatment is consistent with the accrual basis of accounting, and corrects the present anomalies in the treatment of grant revenue by the not-for-profit sector.

We include as Appendix 1 to this letter our responses to some of the specific issues raised in ED 147.

Should you wish to discuss the issues raised further, please contact Richard Lindner (03 9629 4700).

Yours faithfully,

UHY Haines Norton

UHY Haines Norton

Level 8, 607 Bourke Street
Melbourne, Vic 3000
GPO Box 1735
Melbourne, Vic, 3001

t +61 3 9629 4700
f +61 3 9629 4722
e mail@melb uhyhn com au
w www uhyhainesnorton com au

Chartered Accountants:
Norman K Lynch
Richard J Lindner
Rodney H Hutton

ABN 48 259 373 375
Harold Lourie
Adam G Roberts

Invitation to Comment on ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)"

Appendix 1: Specific Matters for Comment

The matters listed below are issues with which we specifically agree or disagree with the content of ED 147. Specific matters for comment *not* included below are generally supported.

(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 do *not* agree that restrictions, as defined by paragraph 8 of ED 147 and distinct from conditions on transferred assets, do not give rise to liabilities on initial recognition of the transferred asset.

Government grant funding is usually contributed to public sector entities for a specific purpose, or in relation to a particular period. Restrictions on the funding can direct the recipient to expend the funds in a certain manner or time period, without the condition that contributions must be refunded if not deployed in the required manner by the required time. Instead, the restriction can be in the form that monies received must be held in trust, with the nature of a liability, until the intended purpose is met.

For example, a not-for-profit entity may receive government grant contributions to complete a long-term research project or for a capital works project. The grant funding agreement does not explicitly contain the condition that should the project not be completed by the end of the financial year that the unspent funds must be repaid. However, the recipient would still be subject to the restriction, as defined by ED 147, that the contributions received must be spent only for the purpose provided. To not recognise a liability for the funds received but not yet expended at year end would understate the future economic benefit outflow the entity will incur in the future, for which it has a present obligation.

We believe the ED 147 definition of "conditions on transferred assets", which recognises the return of transferred assets to the contributor as the only liability recognition criteria in relation to contributed assets, is too narrow to reflect the current Australian government grant funding requirements and obligations of recipients. This narrow definition will have the effect of imposing the form of a grant funding agreement over the substance, intent and process of grant funding, regardless of the discussion in paragraphs 21 to 26 of ED 147.

The Australian Framework for the Preparation and Presentation of Financial Statements includes relevance, substance over form, and comparability amongst the qualitative characteristics of financial reports. Any strict definition within an accounting standard that would compel the recognition of contributions as revenue in one financial year, and the directly related expenditure in subsequent financial years as opposed to the generally accepted accounting principle of "matching" income and expenditure, is a move away from these general principles and would only confuse rather than enhance the understanding of users of general purpose financial reports.

Invitation to Comment on ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)"

Appendix 1: Specific Matters for Comment

(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). IPSAS 12 currently requires inventory to be initially recognised at cost, and IPSASs 16 and 17 currently require that were assets are acquired for no cost or a nominal cost, their cost is their fair value as at the date of acquisition.

We agree that assets acquired in a non-exchange transaction should be measured at their fair value at the date of acquisition.

However, ED 147 and the question above appears to assume that the date of initial recognition is the same as the date of acquisition. In many public sector entities, there is a significant delay between the actual date of acquisition, at which time control is assumed by the entity, and the date of initial recognition due to the practical difficulties in identifying, quantifying and valuing assets. The value of the assets could be materially different if assets were permitted to be measured at the date of recognition rather than the date of acquisition.

For example, "stocktakes" undertaken by local government entities as part of asset register improvement and accountability processes often identify assets not previously recognised, including infrastructure assets contributed by developers. The local government entity may have controlled the asset for a number of years, without recognising the asset.

The distinction between the date of acquisition and the date of recognition is really a question of whether the recognition of assets acquired in a previous reporting period is:

1. one revenue recognition transaction, measured at the fair value at the date of recognition; or
2. a revenue transaction measured at fair value at the date of acquisition, and a valuation adjustment for any movement in fair value between that date and the date of recognition.

We believe the proposals contained in paragraphs 38 and 39 of ED 147 are a significant improvement on the proposed accounting treatments in Section 10 of ED 125 "Financial Reporting by Local Governments", but further explanatory guidance should be included to address situations where the date of recognition is not the same as the date of acquisition.

Invitation to Comment on ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)"

Appendix 1: Specific Matters for Comment

(h) Require that a liability be recognized in respect of an asset transferred subject to conditions upon which initial recognition of the transferred asset (paragraph 50). When the condition has been satisfied the liability is reduced, or derecognized, and revenue recognized. 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 paragraph 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?

We agree with the gross recognition approach in the requirement that a liability be recognised in respect of an asset transferred subject to conditions, and subsequently reduced when the condition is satisfied, and revenue recognised. This approach is consistent with the definition of liabilities and the qualitative characteristic of prudence discussed in the Australian Framework for the Preparation and Presentation of Financial Statements.

The introduction within an accounting standard of an assessment of probability into the recognition of a liability would conflict with the overall accounting framework and understood definitions.

We agree with the IPSASB's assessment summarised in paragraph BC11 that deferral of recognition of a liability based on a probability judgement at the time the related asset is received could result in premature revenue recognition, and corrections in future accounting periods as the factors influencing a probability judgement change.

The requirements relating to the recognition of a liability should apply equally to depreciable and non-depreciable assets. Accounting Standard AASB 116 paragraph 55 directs depreciation to begin when an asset is available for use. We would anticipate only rare and unusual circumstances in which the use of a depreciable asset does not increase the probability a condition will be satisfied, thereby allowing derecognition of at least part of the liability and recognition of revenue.

(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 recognized (paragraph 54). Are there any non-exchange transactions in which it would be appropriate to initially recognize the gross inflow of economic benefits or service potential represented by the asset as revenue even if a liability is also recognized, with the simultaneous recognition of an expense for the liability?

We are not aware of any non-exchange transactions in which it would be appropriate to recognise a gross asset and revenue transaction, as well as expense to correspond with the recognition of a liability. The liability would usually not be recognised without the contribution transaction, and overstatement of revenue & expenses would result. The gross recognition method would separate one transaction into two.

Invitation to Comment on ED 147 "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)"

Appendix 1: Specific Matters for Comment

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

We do not submit a comment on the proposed accounting treatment of advance receipts related to taxes (paragraph 67).

In relation to advance receipts related to transfers (paragraph 105) that contributions received in advance should be recognised as liabilities until the past event which makes the transfer arrangement binding has occurred. Further to our discussion above in relation to (e), the application of the definitions of "conditions" and "restrictions" on timing requirements could compel public sector entities to recognise a full year's operating grant revenue in the wrong reporting period, and not recognise any grant revenue in the following reporting period, merely because the grant funds are received a couple of days prior to year end.

A requirement to recognise a liability for operational contributions received in advance of a reporting period would be adequately disclosed to users in financial statements through the reconciliation between the Income Statement and the Cash Flow Statement, without distorting the profit/loss for the year of receipt and the following year.

The Board needs to be aware of the strong budgetary and financial accountability environment that exists in the Australian public sector entity. Any proposal that usurps this reporting environment and the matching of income and expense within a period in favour of cash flow reporting does not best serve the information needs of users of financial statements.

(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?

We do not believe reporting entities in Australia require a five year transitional period to implement the requirements of ED 147 in respect of other non-exchange transactions. The requirements of ED 147 are not significantly different to the current requirements of Accounting Standard AASB 1004 "Contributions".

In fact, we believe some public sector and not-for-profit entities may elect to adopt any resulting Accounting Standard early, as it resolves a number of current practical issues caused by AASB 1004.