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

Dear Mr Boymal

**EXPOSURE DRAFT ED 147 – REVENUES FROM NON-EXCHANGE
TRANSACTIONS (INCLUDING TAXES AND TRANSFERS)**

Please find attached the Heads of Treasuries Accounting and Reporting Advisory Committee's (HoTARAC) submission on ED 147 *Revenue from Non-Exchange Transactions (Including Taxes and Transfers)*, together with a copy of the detailed comments submitted by HoTARAC to the International Public Sector Accounting Standards Board on ED 29.

HoTARAC disagrees with the fundamental principle in ED 147 that a grant with an in-substance condition gives rise to a liability on initial recognition. Instead, HoTARAC strongly supports the alternative view that a liability in relation to a grant only arises in relation to a condition when it is probable that a condition would be breached.

However, HOTALARAC views "time" as a separate criteria or dimension of a contribution, such that grants should be recognised as revenue:

- in the period in which the grant is required to be used; and
- as a liability where money is received prior to that time period.

In addition, HoTARAC is concerned with the statement in ED 147 that it "may form the basis of a proposed revision of AASB 1004 *Contributions*" (ED 147, Preface, p iv). HoTARAC notes that IPSASB standards are not widely supported by major jurisdictions across the world, do not take a sector neutral approach and are rules based rather than principles based. For these reasons, HoTARAC believes that, in addition to consideration of the IPSASB proposals, the AASB should also re-examine the work it has already undertaken as part of its review of ED 125 *Financial Reporting by Local Governments*.

If you have any queries regarding HoTARAC's comments, please do not hesitate to contact either Robert Williams (Ph: 02 9228 3019) or Dianne McHugh (Ph: 02 9228 5340) from New South Wales Treasury.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE

May 2006

Encl

Contact: Douglas Clow
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Our Ref: D/001261 DC/CJ

Mr Philippe Adhémar
Chairman
International Public Sector Accounting Standards Board
545 Fifth Avenue, 14th Floor
NEW YORK, NEW YORK 10017

Dear Mr Adhémar

**EXPOSURE DRAFT 29 – REVENUE FROM NON EXCHANGE TRANSACTIONS
(INCLUDING TAXES AND TRANSFERS)**

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to Exposure Draft ED 29 *Revenue from Non-Exchange Transactions (Including Taxes and Transfers)*.

HoTARAC disagrees with the fundamental principle in ED 29 that a grant with an in-substance condition gives rise to a liability on initial recognition. Instead, HoTARAC strongly supports the alternative view that a liability in relation to a grant only arises in relation to a condition when it is probable that a condition would be breached. In HoTARAC's view, the proposed treatment in ED 29 does not satisfy the recognition criteria for a liability, as the outflow is not probable.

Rather, HoTARAC considers that, a conditional grant is more in the nature of a contingency. The contingency is a potential liability that may arise, should an "in-substance" condition not be satisfied. Further, HoTARAC views "time" as a separate criteria or dimension of a contribution, such that grants should be recognised:

- as a revenue in the period in which the grant is required to be used; and
- as a liability where money is received prior to that time period.

HoTARAC recommends that the treatment of "time" is explicitly clarified, by providing guidance regarding the accounting treatment of:

- Multi-year grant agreements i.e. recognise as revenue in the annual period to which the grant is to be used;
- Operating grants paid prior to the financial year to which they relate – initially recognise as a liability on receipt and revenue in the period in which the grant is required to be used; and

- Capital grants for the construction of an asset - recognise as revenue, generally as a percentage completion of the asset, or another method, such as over the term of the grant agreement where that better reflects the pattern of revenue recognition.

In addition, HoTARAC supports the principle that tax revenue should be recognized when the taxable event occurs. However, in practice, HoTARAC believes that reliable measurement of certain tax revenue is often not possible until some time after the taxable event. This is due to the difficulty of reliably measuring events of which the taxing authority is not aware until returns are received from taxpayers.

Finally, HoTARAC's preference is for a more principles based rather than rules based Standard. In this regard, HoTARAC believes that the current format of the Exposure Draft is somewhat repetitious and rules based. The exemptions for administrative restructures and contributions by owners should also be better stated.

More detailed comments on these and other matters are attached. If you have any queries, please do not hesitate to contact either Robert Williams (Ph: 612 9228 3019) or Dianne McHugh (Ph: 612 9228 5340) from New South Wales Treasury.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE

May 2006

Encl

cc Mr David Boymal, Chairman, Australian Accounting Standards Board

EXPOSURE DRAFT ED 29
REVENUE FROM NON-EXCHANGE TRANSACTIONS
(INCLUDING TAXES AND TRANSFERS)

GENERAL COMMENTS

HoTARAC disagrees with the fundamental principle in ED 29 that a grant with an in-substance condition gives rise to a liability on initial recognition.

HoTARAC strongly supports the alternative view that a liability for a grant only arises in relation to a condition when it is probable that a condition would be breached. In a non-exchange transaction, there is no reciprocity, as value is not given directly in exchange. As such, by definition, a condition cannot create a present obligation, unless it is likely to be breached and the money returned. This is also acknowledged in the Exposure Draft where it states that, for a non-exchange transaction, a performance obligation in itself does not give rise to a liability (paragraph 16).

Therefore, in HoTARAC's view, the proposed treatment in ED 29 does not satisfy the recognition criteria for a liability i.e. it is not a liability because there is no present obligation and because the outflow is not probable. Rather, in HoTARAC's view, a conditional grant is a contingency, in terms of IPSAS 19 (or IAS 37). That is, a potential liability that may arise, if a condition is not satisfied in the future.

A contingent liability as defined in IPSAS 19 (and IAS 37), includes:

“...a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity...” (IPSAS 19.18 and IAS 37.10)

The IPSASB previously rejected the view that a liability should only be recognised when it is probable that a condition will be breached, on the basis that it could result in entities recognising revenue prematurely. However, in HoTARAC's experience, there is a much greater risk that application of the IPSASB's preferred treatment could inappropriately defer revenue recognition. That is, recognition of a liability up-front for 100 per cent of a grant, where in all probability the condition will be satisfied, is inconsistent with the probability recognition criteria and distorts the substance of the transaction.

However, as part of this alternative view, HoTARAC believes that a likely breach of a condition can only give rise to a liability where the stipulation is an “in-substance” condition. In determining this, the substance rather than the form of the transfer must be emphasised. HoTARAC agrees that the mere specification of a condition is in itself insufficient and that a number of minimum features must be displayed (e.g. specification of what is to be provided, reliable acquittal process etc., as proposed in the Exposure Draft), based on a substance over form approach.

In addition, HoTARAC views “time” as a separate criteria or dimension of a contribution. HoTARAC believes that for grants, because they are non-exchange transactions, time is the underlying event that gives rise to revenue. The recognition of a liability where a transfer occurs in advance of the underlying event that gives rise to the revenue is similar to the requirement in the Exposure Draft for taxes to be recognised:

- as an asset and revenue when the taxable event occurs (paragraph 60); and
- where money is received prior to the taxable event, for a liability to be recognised where money is received prior to the taxable event (paragraph 67).

For taxes, the taxable event may include the earning of assessable income or the purchase or sale of taxable goods (where reliably measurable) and therefore, where tax is received in advance of that event, a liability should be recognised.

However, for grants, HoTARAC believes that “time” is the underlying event or equivalent of the taxable event. That is, where grants are received prior to the time period for which it is to be used, a liability should be recognised. As grants are non-reciprocal, the substance of such arrangements is that, once general pre-entitlement stipulations are satisfied, “time” is the event that results in revenue recognition; rather than satisfaction of any specific performance obligations. In particular, HoTARAC believes that the application of the criteria of “time” results in the following accounting treatments:

- Multi-year policy grant agreements - These types of grants should be recognised as revenue in the annual period in which they are to be used, reflecting the substance of the arrangements as annual agreements provided to fund certain purposes.
- Operating grants paid prior to the financial year they relate to - Where grants are paid prior to the financial year in which they are to be used, these should initially be recognised as a liability (or advance receipt) on receipt and recognised as revenue in the period in which they are required to be used.
- Capital grants - Where grants are provided for capital purposes to construct an asset, time relates either to the period of the grant agreement or the construction of the asset. Therefore, revenue should be recognised generally based on the percentage of completion of the asset, or another method, such as over the term of the grant agreement where that better reflects the pattern of revenue recognition. The percentage of completion approach appears more consistent with IPSAS 11.

These and other comments are discussed in more detail below.

SPECIFIC MATTERS FOR COMMENT

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

Agree. However, in addition, HoTARAC believes that the Exposure Draft should also exclude from its scope, contributions from, and distribution to, owners (paragraphs 40-41 and paragraphs 77-81). Entity combinations that are non-exchange transactions are an important example of contributions from owners. Therefore, both of these issues need to be addressed together. These are important issues that require additional guidance. However, as the treatment of non-exchange entity combinations has not yet been resolved, all contributions from owners, whether arising from an entity combination or otherwise, should be excluded from the scope of this Exposure Draft.

- (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 these compulsory contributions to social security schemes should be explicitly excluded from scope?**
 - (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)**

Social policy obligations

HoTARAC believes that compulsory contributions to social security schemes should be explicitly excluded from the scope of the Exposure Draft. Compulsory contributions to social security schemes should be considered in the entire context of social policy obligations. Therefore, this should be examined as part of the Board's project on social policy obligations. Notwithstanding this, HoTARAC is strongly of the view that the accounting treatment for social policy obligations should be consistent with the general principles for other non-exchange transactions.

Other scope issues

HoTARAC believes that the Exposure Draft should address both revenues and expenses arising from non-exchange transactions, but exclude social policy obligations (as per above). This is particularly important for grants, to ensure symmetry in treatment between grantors and grantees.

HoTARAC also believes that the Exposure Draft should clarify that appropriations under purchaser-provider models may be in-substance exchange transactions, that fall under other revenue standards, and are therefore excluded from its scope. See "other comments" below.

Further, to assist in clarity, HoTARAC would prefer that the title of the Exposure Draft should explicitly include "grants, taxes, fines and donations", as the most common types of non-exchange transactions. The commentary to the Exposure Draft should still define non-exchange transactions and clarify that "grants" encompasses appropriations and "taxes" encompasses fees.

- (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.**

Non-exchange transactions

The definition of "non-exchange transactions" used in the Exposure Draft is problematic and requires additional guidance. The Exposure Draft adopts a similar definition to that used in Australia for "non-reciprocal transfers". However, this definition has caused problems in Australia and has, in part, led to the current review of this area (refer Australian Exposure Draft ED 125 *Financial Reporting by Local Governments*). This is because of difficulties in distinguishing between reciprocal and non-reciprocal transfers.

In particular, different views have arisen as to what is meant by giving value directly to parties to the transfer and whether it is relevant. For example, some commentators argue that the provision of funds on the condition that goods or services are provided to other persons is incidental to the main transactions and that the transfer should be viewed as reciprocal. To clarify this, other commentators have argued that the word “directly” should be removed. This is symptomatic of the difficulties in the definition.

Further, as discussed in the response to paragraph (a) above, it is recommended that the IPSASB amends the definition of non-exchange transactions to explicitly exclude contributions from owners.

An alternative approach to specifying an exchange/non-exchange definition is to instead focus on the circumstances or the minimum features of arrangements that are likely to give rise to a liability. This approach was being considered by the Australian Accounting Standards Board as part of its deliberations on ED 125 *Financial Reporting by Local Governments* and may warrant further consideration (also refer response to paragraph (h) below also refers).

- (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.**

HoTARAC agrees that a particular transaction may comprise two components that should be recognised separately.

However, HoTARAC believes the existing guidance within the Exposure Draft should be expanded to provide guidance in situations where the transaction cannot be readily split into an exchange and non-exchange component. This could occur in situations where there is no observable market information to estimate the fair value of the service provided in the exchange component, or where there is insufficient detail to arbitrarily separate the two components.

In these cases, the Exposure Draft should adopt a default position that the whole transaction should be accounted for as a non-exchange transaction.

- (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?**

HoTARAC agrees that a restriction does not give rise to liabilities on initial recognition.

- (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 & 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.**

HoTARAC agrees with this proposal. However, additional guidance is required regarding when a claim becomes enforceable. Without adequate guidance, HoTARAC is concerned that a grant (or appropriation) receivable may be recognised prematurely.

For example, for appropriations, some argue that an appropriation is enforceable once Parliament has passed an Act; others may argue that it is enforceable at an earlier point or a later point. To illustrate, Example 9 adopts a legal control approach and argues that an Appropriation Bill is enforceable when proclaimed. However, this may not necessarily hold in all jurisdictions. That is, an Appropriation Act may not be enforceable on the proclamation date, as the Act may pertain to a particular year, even though it is proclaimed on an earlier date. The criterion of “time” is further discussed in the response to paragraph (k), below.

Also, even with the adoption of annual budgeting, appropriations may be “accrual” or “cash” based, impacting on their recognition.

Further, while the concept of legal control and enforceability may be a consideration for appropriations (but not necessarily the determining factor), it may not be relevant for certain grants that are the subject of arrangements that are merely agreements, or memorandums of understanding, that do not necessarily have the force of law, and are dependent on an annual appropriation process.

For example, some argue that the existence of a multi-year grant agreement that specifies an annual schedule of payments provides evidence of its enforceability. On this basis, they may argue that a receivable and revenue should be recognised for the total period of the grant agreement from the date of signing. However, in HoTARAC’s view, in many circumstances in government, control cannot be demonstrated under these multi-year agreements until cash is transferred. That is, the reality is that the agreement represents a commitment, or an intention, rather than a binding enforceable agreement. As a result, control is usually taken to occur on the annual receipt of the grant, or annually, once the appropriation is approved. This is because, in general, appropriations are made annually and Governments can only bind themselves as part of this annual process.

A similar issue arises for the transferor and the recognition of the present obligation. Critical to this issue is the distinction between a future commitment and a present obligation. This also concerns the relationship with IPSAS 19 and the recognition of liabilities. The following Australian guidance may help clarify this issue:

- “Where it is intended that a government department will make payments to other parities, whether as a result of government budget policy, election promises, or a statement of intent, this does not of itself create a present obligation which is binding on the government department. A liability would be recognised only where the government is committed in the sense that it has little or no discretion to avoid the sacrifice of future economic benefits”. (AAS 29, paragraph 8.1.4)

- “... The formal adoption of a budget, the passing of appropriation legislation, or the establishment of a grant programme by a government do not, of themselves, create present obligations for the government.” (per former SAC 4, paragraph 59)

HoTARAC considers that this guidance should be expanded, as discussed above.

- (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 & Appendix). IPSAS 12 currently requires inventory to be initially recognised at cost, and 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.**

HoTARAC agrees with this proposal. In addition, HoTARAC encourages the IPSASB to include greater guidance in the Exposure Draft on what constitutes fair value.

HoTARAC’s view is that the fair value for taxes and grants expected to be settled would be the transaction price, or for assets received, observable market prices. However, where there is no observable market data, to prevent divergent interpretations, guidance should be issued. Notwithstanding this, for certain taxes, reliable measurement may not be possible until some time after the taxable event (refer “other comments”, below).

- (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 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?

Subject to HoTARAC’s response to paragraph (k) below, HoTARAC agrees with the alternative proposal, that recognition of a liability should only occur where it is probable that the condition will not be satisfied. HoTARAC believes that conditions are equally applicable to depreciable and non-depreciable assets.

The Exposure Draft acknowledges that a performance obligation does not, in itself, give rise to a liability (paragraph 16). Therefore, in HoTARAC’s view, a liability arises only, either where it is probable that a condition will be breached and the funds will be required to be returned or, as discussed more fully in paragraph (k) below, the criteria of time has not been met. Recognition of a liability up-front for 100 per cent of a grant, where in all probability the condition will be satisfied, is inconsistent with the probability recognition criteria and distorts the reality of the transaction.

The Exposure Draft is based on the false premise that a condition, by definition, gives rise to a liability because the recipient either has to transfer future economic benefits to third parties or return the asset. However, this is inconsistent with the previous conclusion (paragraph 16) that a performance obligation does not give rise to the liability. In HoTARAC's view, as a non-exchange transaction, by definition there can be no performance obligation that creates a present obligation, unless an in-substance condition is likely to be breached. Also, this proposed standard has a view of grant obligations which does not accord with reality. In HoTARAC's experience the circumstances are such that, in substance, very few grants are considered to have failed their conditions and consequently have created an obligation to return the asset. However, an occasional consequence is that subsequent grants may be withheld or reduced.

Rather, in HoTARAC's view, a conditional grant is more in the nature of a contingency, in terms of IPSAS 19 (or IAS 37). That is, a potential liability that may arise, if a condition is not satisfied in the future.

Some may argue that the IASB's proposed amendments to IAS 37 (published June 2005) are a more theoretically sound treatment for contingencies. However, even if these proposals are accepted and contingencies are recognised as a liability, HoTARAC believes that the outcome will be the same. That is, by taking the probability that the condition would not be met into account, the fair value of any liability in most circumstances would be immaterial. This is because generally in the public sector across Australian jurisdictions, stipulations are either not in-substance conditions or conditions are generally satisfied.

However, as part of this alternative proposition, HoTARAC believes that a liability can only arise where it is probable that an in-substance condition is likely to be breached. In determining this, the substance, rather than the form of the transfer, must be emphasised. HoTARAC agrees that the mere specification of a condition is, in itself, insufficient and that a number of minimum requirements must be met.

In this regard, HoTARAC believes that the IPSASB should consider the approach proposed by the Australian Accounting Standards Board, to specify the minimum features of conditions that are necessary to give rise to a liability, based on a substance over form approach (although as above, HoTARAC argues that these would only give rise to a liability where it is probable that the condition would be breached). Examples of the types of characteristics (based on a combination of the proposals in the IPSAS Exposure Draft (paragraph 24) and the Australian Exposure Draft ED 125) are outlined below:

- Specification of the nature and quantum of goods and services to be provided or nature of assets to be acquired.
- Period within which performance is to occur.
- Reliable acquittal process (i.e. performance needs to be monitored) to determine whether goods and services have been provided.
- Right to refuse payment or demand repayment where acquittal indicates that the goods and services provided are less than the agreed quantity or quality.
- Demonstration that the acquittal process operates in practice i.e. that the right of return is exercised where adequate acquittal does not occur.

Further, HoTARAC agrees that inclusion of a term, in a transfer, that requires the entity to perform an action that it has no alternative but to perform, is not, in substance, a condition. This should be further elaborated in the Exposure Draft. For example, HoTARAC suggests that the Exposure Draft should clarify that including a trivial condition, which in all likelihood will be met, cannot give rise to a liability. This is also based on HoTARAC's view that a liability can only arise where an in-substance condition is likely to be breached. Therefore, by definition, a trivial condition cannot give rise to a liability.

For similar reasons, HoTARAC disagrees with the conclusion that, where there is no past experience or evidence as to whether the transferor would enforce a requirement, an entity should assume that the transferor would enforce the condition. The reason for there being no past experience may be that the condition is trivial and/or will, in all probability be met, as discussed above. In HoTARAC's view, there is no in-substance condition and no liability arises, where there is no past experience or evidence about whether the transferor would enforce a requirement.

- (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).**

HoTARAC agrees that, in accordance with the principles of IPSAS 19, the amount recognised as a liability must be the best estimate of the amount required to settle the present obligation. However, in the future, IPSASB may need to consider the impact of proposed amendments by the IASB to IAS 37 *Provisions*, as discussed in the response to paragraph (h) above.

- (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 asset as revenue even if a liability is also recognised, with the simultaneous recognition of an expense for the liability?**

As discussed in the response to paragraph (h) above, HoTARAC believes that the recognition of an asset gives rise to the recognition of revenue, except to the extent that it is probable that a condition will be breached.

HoTARAC does not believe it is appropriate to recognise an asset and revenue, with the simultaneous recognition of an expense and a liability. This would appear to distort the financial information of the entity.

- (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).**

HoTARAC agrees that a liability should be recognised in these circumstances. However, HoTARAC prefers the argument that "time" is another criteria or dimension of contributions as was previously proposed in the Invitation to Comment (but was rejected by the IPSASB). Where monetary grants are provided to be used or "pertain" to a particular financial reporting period, HoTARAC is of the view that the payment of grants in advance of that period represents a liability (i.e. a liability to use or consume the resources in the period specified).

This is also consistent with the United States GASB 33 *Accounting and Financial Reporting for Non-exchange Transactions*.

HoTARAC believes that, for grants that are non-exchange transactions, time is the underlying event that gives rise to revenue. The recognition of a liability, where a transfer occurs in advance of the underlying event that gives rise to the revenue, is similar to the requirement in the Exposure Draft for taxes to be recognised:

- as an asset and revenue when the taxable event occurs (paragraph 60); and
- where money is received prior to the taxable event, for a liability to be recognised where money is received prior to the taxable event (paragraph 67).

For taxes, the taxable event may include the earning of assessable income or the purchase or sale of taxable goods (where reliably measurable). Therefore, where tax is received in advance of that event, a liability should be recognised.

This is also consistent with the Basis for Conclusions, paragraph BC 21 which states that “...advance receipts of taxes particularly, are no different to other advance receipts and that a liability will be recognised until the taxable event occurs”.

However, for grants, HoTARAC believes that “time” is the underlying event or equivalent of the taxable event. That is, where grants are received prior to the time period for which it is to be used, a liability should be recognised. As grants are non-reciprocal, the substance of such arrangements is that, once general pre-entitlement stipulations are satisfied, “time” is the event that results in revenue recognition, rather than satisfaction of any specific performance obligations. However, as currently drafted, it is unclear how the concept of advance receipts applies to different types of grants and circumstances.

Therefore, HoTARAC recommends that this is explicitly demonstrated by way of example i.e.:

- Multi-year policy grant agreements - These agreements cover a number of years, but are typically paid annually or relate to annual periods. These types of grants should be recognised as revenue in the annual period in which they are to be used, reflecting the substance of the arrangements as annual agreements provided to fund certain purposes. Further, these agreements do not result in present obligations (unless breached) as they represent intentions or commitments rather than a liability. Accordingly, these agreements typically only become binding on an annual basis, once appropriations are made or as otherwise authorised. As a result, control of the asset is usually taken to occur on the annual receipt of the grant or annually once the appropriation is approved.
- Operating grants paid prior to the financial year they relate to - Where grants are paid prior to the financial year in which they are to be used, these should initially be recognised as a liability (or advance receipt) on receipt and recognised as revenue in the period to which they are required to be used.
- Capital grants - Where grants are provided for capital purposes to construct an asset, time relates either to the period of the grant agreement or the construction of the asset. Therefore, revenue should be recognised generally based on the percentage completion of the asset, or another method, such as over the term of the grant agreement where that

better reflects the pattern of revenue recognition. The percentage of completion approach is more consistent with IPSAS 11.

However, in other circumstances, grants are subject to the general principle outlined in paragraph (h) above i.e. a liability only arises where it is probable that an in-substance condition is likely to be breached.

Further, grants should be differentiated from donations. Grants, unlike donations, are usually subject to more detailed agreements that are framed around time requirements, as well as more specific performance obligations. Therefore, “time” is not usually relevant to the recognition of donations. Donations in substance are given to an entity with no constraint over the application of the assets other than any binding constitution or rules of the entity.

As the proposed Exposure Draft is currently drafted, a grant agreement that stipulated that it must be used in a particular period, or else returned, would not meet the definition of a condition. This is because there is no performance obligation (i.e. a requirement to use or consume the future economic benefits in the asset for a particular purpose). Therefore, “time” is only addressed in the Exposure Draft as part of the concept of “advance receipts”. However, unlike a condition, the notion of advance receipts does not require a return obligation. Therefore, implicitly, while not the intent of the IPSASB, this seems to acknowledge that time is another criteria or dimension of a contribution. HoTARAC would prefer that this be made more explicit.

Further, the Exposure Draft states that, for an asset granted on condition that a matching contribution is obtained, the recipient will need to consider whether these transfers are in the nature of an advance receipt. HoTARAC does not believe that the concept of advance receipt is relevant here, as the stipulation does not pertain to “time”. In HoTARAC’s view, in these circumstances, a liability should only be recognised when it is probable it will be returned. This is consistent with paragraph 25 of the Exposure Draft, but inconsistent with paragraph 26, which considers the application of an advance receipt.

(l) Not permit the netting of expenses paid through the tax system (see paragraphs 72-76) against tax 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.

HoTARAC agrees with this proposal.

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

HoTARAC agrees with this proposal. This would allow, for example, an individual jurisdiction to recognise services-in kind as revenue and an asset, where the fair value of those services can be reliably measured and those services would have been purchased if not provided free of charge.

- (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?**

HoTARAC disagrees with this proposal and believes that transitional provisions should be a matter for each individual jurisdiction to determine. Further, the disadvantage of transitional provisions is that it may imply that after a transitional period, all taxation revenue should be able to be recognised reliably based on the taxable event. However, in HoTARAC's view, certain types of tax revenue will never be capable of reliable measurement based on the taxable event, due to the particular nature of the tax. This is further discussed below.

(o) Other issues

Rules versus principles

HoTARAC's preference is for a more principles based rather than rules based Standard. In this regard, HoTARAC believes that the current format of the Exposure Draft is unduly repetitious and rules based. The structure of the Exposure Draft is difficult to understand, as it duplicates discussion in a number of areas. For example, the section on transfers (paragraphs 77-105) duplicates a number of concepts discussed earlier in the Exposure Draft.

Appropriations

HoTARAC believes that additional discussion is required regarding different appropriation models, including purchaser provider and funding models. Further, appropriations that are in-substance purchaser provider models and meet the definition of exchange transactions should be excluded from the scope of the Exposure Draft and should be addressed as part of the Revenue Standard (IPSAS 9). In these instances, individual jurisdictions have implemented specific methodologies to determine when revenue should be recognised based upon performance.

Reliable measurement of taxes

HoTARAC supports the majority of proposals within the Exposure Draft on the recognition of taxes, noting that, while more expansive, these are broadly similar to current Australian Accounting Standards requirements.

However, HoTARAC is of the view that, in practice, reliable measurement of certain tax revenue is often not possible until some time after the taxable event. This is due to the difficulty of reliably measuring events of which the taxing authority is not aware until returns are received from taxpayers. It is not always possible to reliably incorporate such events into a statistical model.

In particular, HoTARAC is concerned that the Exposure Draft might be viewed as requiring a Government to adopt an estimation process, even where this is viewed as unreliable. HoTARAC therefore believes that IPSASB should expand the guidance provided in paragraph 71, to recognise that it is not uncommon for a Government to be unable to establish a reliable measurement, where the estimation process is highly assumption driven and the taxation base is subject to volatility. The adoption of a later recognition point in these cases is regarded as the only way to achieve reliable measurement.

The emphasis on estimation models, and the view of some constituents, that reliable measurement is always possible, may result in a situation where a Government is forced to continually expend resources developing new estimation models where reliable measurement has proven not possible. HoTARAC believes the IPSASB needs to reflect a cost versus benefit approach within the Exposure Draft to avoid potential issues.

HoTARAC notes that estimation models will necessarily be based on a combination of history and assumptions. As assumptions are necessarily subjective, the model developed may not be sufficiently robust to provide audit assurance. The model parameters are also likely to change each year compounding the audit issue. The change in parameters may mean past model history, used to validate the model and assess a Government's ability to reliably measure taxation revenue, may not be relevant to judge the model's expected error rate in the current period. This may mean that the audit opinion is necessarily qualified, due to an inability to obtain reasonable assurance over the model used.

Finally, HoTARAC supports the discussion on the tax gap included in the Basis of Conclusions (paragraphs BC24-BC25). This clarifies that the tax gap does not meet the definition of an asset, as it is not expected that resources will flow to the Government in respect of these amounts. HoTARAC believes that this should be included in the body of the Exposure Draft.

Fines

Fines are discussed in paragraphs 89 and 90 under the general heading of "Transfers". HoTARAC suggests that fines would be more appropriately discussed under a combined heading of "Taxes and Fines."

Rates

HoTARAC notes that many local government rates would be non-exchange transfers and considers that they should be specifically considered.

Administered or trust/agency relationships

HoTARAC believes that, where there is an in-substance agent or trust relationship, the definition of an asset is not satisfied.

HoTARAC believes that additional guidance is required regarding the distinction between the concept of control and administered or trust/agent activities. This is particularly an issue where a government agency is used as a mailbox, or conduit, to transfer monetary or non-monetary assets (including grants) to third parties i.e. where the agency administers rather than controls an asset and has no discretion. At present, agency relationships are only discussed in the Exposure Draft in the context of taxes but not grants.

Distinction between conditions and restrictions

While the guidance on stipulations, conditions and restrictions is considered beneficial, HoTARAC is concerned that there is the potential for a reasonable person to consider a stipulation is either a condition or restriction. This suggests that further guidance and clarification is required.

The examples within the Exposure Draft at paragraph 23 and Example 9 in the illustrative guidance are an indication where a reasonable person might come to a different conclusion.

The two scenarios are highly similar, but one is concluded to be a condition whereas the other is deemed a restriction. Therefore, it is important that the examples provided in the Exposure Draft consider the substance of the transaction, as discussed in paragraph (h) above.

Consistency between for-profit and not-for-profit entities

In HoTARAC's view, ultimately, there should be consistency in accounting treatment of grants for both for-profit (including GBE's) and not-for-profit entities. In this regard, it is noted that the IASB equivalent on grants, *IAS 20 Accounting for Government Grants and Disclosure of Government Assistance* is due to be revised. Once this has occurred, there should be consistency in treatment between for-profit and not-for-profit entities. This is an important consideration, given that the whole-of-government economic entity often comprises both for-profit and not-for-profit entities. Where a grant is made by a not-for-profit entity to a for-profit entity, there should be symmetry in accounting treatment in order to avoid any consolidation adjustments.