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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
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30 November 2009

Dear Kevin

Submission – AASB ED 180 *Income from Non-exchange Transactions (Taxes and Transfers)*

We are pleased to have the opportunity to comment on ED 180 *Income from Non-exchange Transactions* (ED).

We support the Boards efforts in addressing the current diversity in practice in accounting for non-exchange transactions. However, we question whether issuing a new standard on accounting for non-exchange transactions by not-for-profits (NFPs) in the private sector is the most appropriate and effective way to reduce the current divergence. We consider this can be more appropriately and effectively addressed by expanding the scope of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* to the NFP private sector and requiring NFPs in the private sector to apply AASB 118 *Revenue* to all other transactions.

Whilst the proposals in the ED may help reduce the current divergence in practice in accounting for non-exchange transactions by NFPs, we are not convinced they will eliminate divergence. In our experience the divergence in practice is predominately due to varying interpretations of what constitutes an exchange or non-exchange transaction and the ED does not provide significant guidance to assist users in this determination. We prefer a framework that does not require this upfront determination but rather a situation whereby NFPs in the private sector are able to account for government grants under AASB 120 with all other transactions accounted for under AASB 118. If IAS 20 was under immediate threat of being amended, then we would not be recommending the scope of AASB 120 be expanded to include NFPs. However, whilst there is an IASB project to amend IAS 20, work on the project has been deferred pending the progress of other related projects and it is likely that AASB 120 in its current format will be in operation for some time.

We do not consider the proposals within the ED to be consistent with the AASB's objective of transaction neutrality in the accounting standards. The proposals contained within the ED will result in for-profits and NFP entities realising different accounting outcomes for identical transactions. Feedback received by the AASB during roundtable discussions on ITC 14 *Proposed Definition and Guidance for Not-for-Profit Entities*, highlighted that NFPs see themselves as operating in the for-profit space, they believe their objectives are consistent with for-profits; to derive surplus income to meet the underlying objectives and strategic goals of the entity and many NFPs compete with for-profits for grants and other forms of assistance. Given NFPs operate in the for-profit environment and directly compete with them, we do not consider it appropriate to require different accounting treatments for similar transactions. We recommend the accounting for NFPs and for-profits be aligned.

However, if the AASB proceeds with issuing a separate standard on accounting for non-exchange transactions by NFPs, then we recommend the AASB maintain the definitions of exchange and non-exchange transactions as worded in the ED, but provide further detailed guidance to assist users in making the distinction.

Additionally we do not agree that the principle contained in the ED that only a condition leads to deferral of revenue will result in financial statements that provide relevant information about the NFP's financial performance and position. Whilst we support the accounting for conditions, we do not support the accounting for restrictions. In our view, assets with restrictions should be recognised over the periods during which the restriction i.e., performance obligation will be satisfied, particularly where a contract is involved as we consider this to be an exchange transaction. This accounting treatment is consistent with the principles in AASB 120 and AASB 118 and results in the more appropriate recognition of revenue in the periods in which the entity performs under the transaction. If the AASB were to proceed with a separate standard, we recommend the AASB amend the proposals to require revenue deferral when a restriction is attached to the asset.

We do not support the proposals to override the recognition requirements in AASB 139 *Financial Instruments: Recognition and Measurement*. AASB 139 is a foundation standard providing guidance on the recognition and measurement of financial instruments. Requiring financial liabilities to be recognised under the requirements contained in the ED and not in those in AASB 139 will create inconsistency between the NFP and for-profit sector in accounting for the same transaction.

Overall, we do not recommend the AASB proceed with this ED but instead expand AASB 120 to the NFP private sector and require NFPs in the private sector to apply AASB 118 to all other transactions.

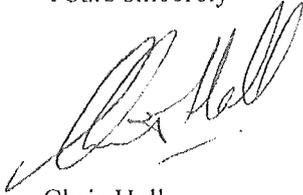
We acknowledge that a separate standard is required for NFPs in the public sector, however this separate standard should take into consideration the concerns we have raised regarding the proposals in the ED. Upon issuing a separate standard for NFPs in the public sector, we agree AASB 1004 *Contributions* should be withdrawn in its entirety.

If the AASB does proceed with a separate standard, then we recommend more guidance is included to assist with distinguishing an exchange from a non-exchange transaction and the recognition requirements for financial assets and liabilities be amended in line with those contained in AASB 139. Furthermore, we recommend the proposal that only a condition results in deferral of revenue is reconsidered and the substance of restrictions be adequately reflected in the financial statements of NFP entities.

Appendix A to this letter comments on the specific questions raised in the ED.

Please contact either myself on (02) 9335 7108 or Kim Heng on (02) 9455 9120 if you wish to discuss any of the issues raised in this letter.

Yours sincerely



Chris Hall
Partner

Appendix A

a) The Boards' approach of developing the proposals based on IPSAS 23

We do not consider IPSAS 23 to be the most appropriate standard to establish the accounting for non-exchange transactions by NFP private sector entities. In our view, the AASB should consider amending AASB 120 to allow NFPs in the private sector to account for government grants in accordance with that standard and for other transactions to be accounted for under AASB 118. We consider this to be the more appropriate application of the Board's stated policy of transaction neutrality.

We acknowledge that a separate standard on accounting for non-exchange transactions is required for NFPs in the public sector; this separate standard should take into consideration the concerns we have raised regarding the proposals in the ED.

b) Whether there are any differences between Australia and New Zealand that would override the Board's desire for converged Standards for non-exchange transactions?

We are not aware of any regulatory or other issues arising in the Australian environment that would override the Board's desire for converged accounting for non-exchange transactions.

c) Whether further guidance or illustrative examples are required in distinguishing exchange or non-exchange transactions or components of transactions, e.g. for local government rates

We disagree with the AASB's attempt to distinguish an exchange from a non-exchange transaction. In our view, both transactions should be accounted for under AASB 120 and AASB 118.

However, if the AASB does proceed with the ED, then we consider further useful guidance and illustrative examples are paramount to assist users in determining what an exchange or non-exchange transaction is. Evaluating whether a transaction is an exchange or non-exchange transaction is an important first step in determining which standard (AASB 118/139 or this ED) should apply. In its current form the ED does not provide adequate guidance to assist users in this determination.

The definitions of exchange and non-exchange transactions contained within the ED are broad and do not significantly differ from the definitions of reciprocal and non-reciprocal contributions as defined in AASB 1004. In our experience, these broad definitions have contributed to the current divergence in practice when accounting for non-exchange transactions.

In many cases it is difficult to determine whether in substance a transaction is an exchange or non-exchange transaction. The difficulty arises due to the nature of how some transactions with NFPs are structured. NFP's predominate source of income is in the form of grants, donations and appropriations which in form may be considered non-exchange transactions. However, in some cases, these grants and donations have strict restrictions attached and are set up on a contractual basis, indicating that in substance, an exchange transaction exists.

For example, consider a charity that receives a grant from the State Government to provide medical assistance to the underprivileged. The charity obtained the grant through a tender process. The grant stipulates that the money must be spent on purchasing and administering vaccines. A formal contract was established between the State Government and the charity outlining the charity's responsibilities. The State Government will conduct bi-annual audits to ensure the charity is adhering to the contractual agreement. There is no requirement to return the funds if monies are not spent as required by the contract. However, if the charity does not fulfil its contractual duties, the State Government may seek penalties from the charity through legal proceedings. The value of the grant and the budgeted cost of fulfilling the contractual duty are expected to result in the charity realising a profit margin.

In applying the ED definitions of exchange and non-exchange transactions to the above example, it is difficult to determine whether this is an exchange or non-exchange transaction. An exchange transaction is defined in the ED as "transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services or use of assets) to another entity in exchange". In the above example, one conclusion is this is an exchange transaction as in return for the grant the charity is required to provide goods and services to the public; it has a constructive obligation to purchase and administer vaccines which has a cost that will result in a profit margin. The other conclusion is that as there is no requirement to return the funds to the State Government this is a non-exchange transaction. Without further guidance, we feel the objective of the ED to reduce divergence in practice in accounting for non-exchange transactions will not be achieved.

Therefore, if the AASB were to proceed with the ED, we recommend the AASB maintain the definitions of exchange and non-exchange transactions as worded in the ED, but provide further guidance to assist users in making the distinction. This further guidance should include a list of specific indicators that would normally be associated with an exchange transaction. These indicators could include, but are not limited to whether:

- the transaction is subject to a competitive tender process;
- the transaction is subject to a binding contract;
- there is a risk of legal proceedings and/or penalties if restrictions are not satisfied;
- there are any control processes (e.g. audits) to ensure restrictions are being complied with;
and
- the costs that will be incurred in performing under the contract result in a profit margin.

The facts and circumstances of a transaction can then be assessed against the established indicators to determine if in substance, an exchange or non-exchange transaction exists.

The difficulty in interpreting and applying the definitions of exchange and non-exchange transactions is not isolated to the private sector. Transactions specific to the public sector such as rates received by local governments may be difficult to categorise as they may be a hybrid of exchange and non-exchange transactions.

Additionally, we note the ED does not address how the scope of IFRIC 18 *Transfers of Assets from Customers* interacts with the scope of the ED. It is not clear whether contributions of assets to the public sector used to connect customers to a network or to provide a customer with ongoing access to a supply of goods or services is an exchange or non-exchange transaction and whether IFRIC 18 or this ED should be applied.

Notwithstanding our comments above, we strongly recommend that the AASB should not be attempting to distinguish an exchange from a non-exchange transaction. In our view, both transactions should be accounted for under AASB 120 and AASB 118.

We acknowledge the NFPs in the public sector may require some specific guidance for public sector issues such as taxes. This may appropriately be provided in a separate standard.

d) The definition and treatment of conditions on transferred assets

If the AASB proceeds with the ED, then we support the definition and treatment of conditions on transferred assets. We agree that when a recipient receives an asset with a condition attached, the recipient is unable to avoid the outflow of resources as it is required to consume the future economic benefits embodied in the transferred asset in delivery of particular goods or services to third parties or else return to the transferor future economic benefits. Therefore, conditions on transferred assets give rise to a present obligation on initial recognition and recognition of a liability is appropriate.

Notwithstanding our general support for the treatment of conditions, we do not support the substance over form guidance outlined in paragraphs 21 to 26 of the ED. In our view, the existence of a condition should not depend on an assessment of whether it is probable or not that the transferor will require the return of an asset. The requirement to return the asset is a contractual obligation that is outside the control of the recipient and consistent with the requirements of AASB 132 *Financial Instruments Presentation* and AASB 139 should result in the initial recognition of a liability. In our experience if conditions and restrictions are not substantive, then there are likely to be other indicators of a non-exchange transaction. That is, if conditions and restrictions have no substance, a non-exchange transaction may exist.

Furthermore, we do not support the treatment of restrictions on transferred assets. We consider assets with restrictions attached also mean that the recipient is unable to avoid the outflow of resources as it is required to consume the future economic benefits embodied in the asset to meet the performance obligation set by the restrictions. Restrictions require an entity to act and allocate their resources in a certain way. This performance obligation should be reflected in the accounting for assets with restrictions. Therefore, we do not consider revenue to be generated until the entity has performed its obligation under the terms of the transaction and therefore revenue should be deferred and recognised over the periods which the restriction will be satisfied. For a restriction to exist, we expect that there must be a significant nexus between the donation and the performance obligation.

For example, consider the recent fire appeals to support victims of the bush fires in Victoria. A number of charities established bush fire appeals; raising donations to help restore the homes and lives of those affected. Donations to a bush fire appeal come with the expectation that the donation will be used in assisting victims of the bush fires and not for any other purposes i.e. other charitable initiatives undertaken by the charity. The charity will disperse these funds to the victims over a number of years as it takes time to restore homes/properties, compensate families for loss of income and to provide ongoing care.

In this example, the ED requires donations to a bush fire appeal to be recognised when the charity obtains control of the cash. However, because there is no return obligation attached to the donations (i.e. no condition attached), a liability is not recognised. This accounting does not reflect the underlying commercial reality of the donation. The donation will be used to provide funding to victims for several years and the charity has a constructive obligation to fulfil this commitment. In our view, a liability should be recognised when the donation is received reflecting the constructive obligation and derecognised as the obligation is satisfied i.e. donations distributed to victims.

Consistent with paragraph 15 of AASB 1004, in situations where performance obligations are nominal, such as acknowledgement letters, general information about the entity's activities and distribution of marketing materials, we do not consider these to be, in substance, restrictions. In the above example, there is a clear and defined nexus between the donations and the bush fire appeal. However, in situations where generic donations are made to charities and a nexus between the donation and a specific appeal or initiative cannot be established, we do not consider these donations to have restrictions attached.

We note in support of our recommendation that NFPs be allowed to apply AASB 118 that application of AASB 118.20 which requires revenue from the rendering of services to be recognised by reference to the stage of completion of the transaction at the reporting date would result in recognition of the donation as services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. Furthermore, the recognition of a liability for future services that provides useful information regarding the entities commitments in future reporting periods.

The proposals in the ED that only conditions result in the recognition of a financial liability appear to be balance sheet focused; if the stipulations in the transaction do not create an obligation that meets the definition of a financial liability, then these stipulations are not conditions and revenue is not deferred. We do not support this approach and believe that it is fundamentally inconsistent with AASB 118 and the direction of the IASB's recently issued discussion paper on revenue recognition. Deferred revenue does not meet the definition of a financial liability yet this is a concept that exists in AASB 118 and is retained in the IASB's proposed revenue recognition model.

Notwithstanding our view that restrictions can also result in the upfront recognition of a liability, we agree that transactions that provide a NFP with an asset and no stipulation other than the funds cannot be spent until a set period of time should not result in the upfront recognition of a liability.

e) The treatment of advance receipts

If the AASB proceeds with the ED, then we agree with the proposal that advance receipts result in the simultaneous recognition of an asset and associated liability.

f) Permitting, not requiring, the recognition of contributions of services

We do not support the proposal to allow entities the option of recognising services-in-kind. Whilst we appreciate the practical difficulties of capturing and measuring the fair value of such services, we feel this proposal will reduce the usefulness of financial statements of NFPs and the comparability of these financial statements as entities will opt for differing accounting policies.

We recommend the recognition requirements for services-in-kind established in AASB 1004 applying to government entities be incorporated and applied to all NFPs within the scope of the ED. Currently, AASB 1004 requires government entities to recognise services-in-kind that would have been purchased had they not been donated. This treatment is consistent with current best practice accounting for services-in-kind and we do not consider it is appropriate to reverse the best practice that has developed.

We would not support a proposal that mandates the recognition of all services-in-kind.

g) Requiring disclosure of the nature and type of major classes of services in-kind received (paragraph 108) – IPSAS 23 encourages but does not require such disclosure

If the AASB proceeds with the ED, then we support the requirement to disclose the nature and type of major classes of services-in-kind received by the NFP.

h) The implications of recognising financial assets and financial liabilities that fall within the scope of this ED in accordance with the proposals rather than AASB 139/NZ IAS 39

We do not support the proposals that the recognition of financial liabilities in the ED override the principles established in AASB 139. To override the recognition requirements of AASB 139 adds unnecessary complexity to the accounting for non-exchange transaction and is inconsistent with the AASB's objective of transaction neutrality in accounting standards.

As the AASB has not articulated the reasons for departing from the recognition principles for financial liabilities in AASB 139, we do not understand how financial liabilities generated by non-exchange transactions are sufficiently different in nature to warrant different accounting to other financial liabilities within the scope of AASB 139. This proposal will further introduce inconsistency between the NFP and for-profit sector in accounting for the same transaction because in certain circumstances a financial liability would not be recognised under the ED when AASB 139 would require recognition.

Furthermore, the example contained within paragraph 25 of the ED is unclear. The first sentence of the paragraph implies that a return obligation exists, however this is not explicitly discussed in the background to the example i.e., it is unclear whether the funds provided by the national government to the provincial government are required to be returned if a matching contribution is not raised. If there is a return obligation, then we disagree with the conclusion that a condition does not exist and that a liability is not recognised on initial recognition of the funds.

We infer from the example that in other transactions whereby a restriction is outside the control of the entity, that the principles in the ED override AASB 139 and a liability would not be recognised. Whilst we disagree with this accounting outcome, if this is the AASB's intention then we recommend this should be explicitly stated in the ED.

i) The measurement requirements, particularly in respect of financial assets and financial liabilities

If the AASB proceeds with the ED, then we agree with the measurement requirements contained in the ED.

j) Prospective application per the transitional provisions

If the AASB proceeds with the ED, then we support prospective application.

(k) The exclusion of for-profit government departments from the scope of the ED – are requirements for such entities still required

If the AASB proceeds with the ED, then we do not have significant concerns regarding this proposal.

(l) The retention of requirements for restructures of administrative arrangements

If the AASB proceeds with the ED, then we do not have significant concerns regarding this proposal.

(m) Whether recognition requirements are needed in respect of contributions from owners and distributions to owners generally

More guidance around accounting of contributions from owners and distributions to owners would be helpful. However, we consider that this will be a significant project in and of itself and any decision to provide further guidance be considered in the context of the IASB's project plans.

(n) The role of AASB Interpretation 1038 once a standard based on the ED is issued

We recommend that AASB Interpretation 1038 is not retired as this interpretation is required to identify contributions by owners to wholly-owned public sector entities.

(o) The proposed amendments to other Australian Accounting Standards, as set out in Appendix A

If the AASB proceeds with the ED, then we do not have significant concerns regarding these proposals.

(p) Whether, overall, the proposals would result in financial statements that would be useful to users

Consistent with our comments above, we do not consider that the proposals would enhance financial statements for users. We consider the ED as currently drafted will not reduce the current divergence in accounting for non-exchange transactions by NFPs due to the lack of guidance surrounding the definitions of exchange and non-exchange transactions.

Additionally, the proposals within the ED, specifically that revenue deferral is not appropriate if only a restriction is attached to an asset will not result in the commercial reality of transactions being reflected in the financial statements. This proposal and the proposal that the requirements of the ED will override the recognition requirements of AASB 139 will further increase the disparity in accounting for similar transactions by the NFP and for-profit sectors. The resulting impact will be that users will find it difficult to compare financial statements across entities in different sectors.

Additionally, in our view, the proposal to allow entities the option of recognising services-in-kind will diminish the comparability of financial statements across similar not-for-profit entities.

Overall, we do not recommend the AASB proceed with this ED but expand AASB 120 to the NFP private sector and require NFPs in the private sector to apply AASB 118 to all other transactions.

(q) Whether the proposals are in the best interests of the Australian economy

In our view, the proposals are not in the best interests of the Australian economy. As previously discussed, we do not agree with the treatment of restrictions as we do not consider revenue to be generated until the entity has performed its obligation under the terms of the transaction and therefore revenue should be deferred and recognised over the periods which the restriction will be satisfied. We feel the proposals, specifically that revenue deferral is not appropriate if only a restriction is attached will result in misleading financial statements as recognising revenue and not the associated performance or constructive obligations presents a financial position that does not appropriately reflect future obligations that will be satisfied through an outflow of resources. This in turn increases the risk of imprudent decision making when decisions are based on the financial performance and position of the entity as presented in the financial statements.

Given the importance of the NFP sector in the Australian economy, we do not consider the proposals are in the best interests of the Australian economy as a whole.