South Australian Local Government
Financial Management Group Inc.

4 December 2009

Mr Kevin Stevenson
Chairman & CEO
The Australian Accounting Standards Board (AASB)
PO Box 204
Collins St West
Melbourne, VIC 8007

Dear Kevin

Re: Exposure Draft 180 – Income From Non-Exchange Transactions (Taxes and Transfers)

In response to the Australian Standards Board seeking comment on Exposure Draft - ED 180, the South Australian Local Government Financial Management Group Inc. (FMG) are presenting the following comments for your consideration (refer enclosed).

The FMG is a peak body representing financial management professionals working in Local Government in South Australia. We believe that it is important to be involved in the standard setting process as a sector and as representative bodies of their memberships. ED 180 is of particular interest as it relates to over 90% of councils income being rates and government grants.

Our membership consists of over 175 members across the 68 councils. FMG represents its members' interests and promotes the highest professional standards and ethical behavior. Supporting continuous improvement through education, interchange of information and best practice, the FMG assists with the understanding and uniform application of the Local Government Act and provides proactive review of current and proposed legislation

Please contact us if you require further clarification, we thank you for the opportunity to provide comment and look forward to the revised standard.

Regards

Robyn Dunstall
President, South Australian Local Government Financial Management Group

1. SA Local Government Financial Management Group Inc.

SA Local Government Financial Management Group Inc. is the professional association representing finance professionals working in local government entities in South Australia. Our members are chief financial officers, financial and management accountants and Council officers working in the finance field.

The comments provided in this submission represent the views of our members.

2. Users of the Financial Reports

The South Australian Government has legislated that the audited annual financial statements of Councils are to be prepared in accordance with the Australian Accounting Standards. Subordinate legislation further requires that certain disclosures are made generally in accordance with Model Statements prepared by the industry, and endorsed by the Minister for State/Local Government Relations.

The predominant users of these general purpose financial reports are ratepayers and other community members, many of whom are not experienced in reading financial statements and rely on the expertise of the financial professionals to present the information in an easy-to-understand format.

The Office of State/Local Government Relations (OSLGR) and the Local Government Association of South Australia (LGASA - the representative body for SA local government) are other major users of these reports, largely for comparative analysis between Councils and analysis of the financial and sustainability situation of individual Councils. While both of these bodies have the ability to require the preparation of special purpose reports, to date both have chosen to seek specific disclosures within the general purpose reports plus the provision of some supplementary returns, rather than to require the preparation of special purpose reports.

> As a professional body, we support the approach taken by OSLGR and LGASA. The audited annual financial statements ***should*** provide the basis of such analysis by OSLGR and LGASA rather than special purpose reports that are not publicly available.

However, we recognise that OSLGR and LGASA - and the vast majority of ratepayers generally - are principally interested in the operational and financial management of the Council, and whether it is matching the services supplied to the resources available, and it is for this reason that a strong budgeting and financial planning regime is in place.

Current Accounting Standards, which determine timing of revenue recognition on the basis of control of funds, disrupt the reporting against budget when timing of cash flow from another level of government to Councils is in advance of the prior year end, or prior to the expenditure to which it relates. Variances between reported grant income and budgeted income are being caused by the Accounting Standards, not necessarily the operations or financial management of the Councils.

> As a professional body, we are concerned that continuing distortions between reported grant income and budgeted income, caused by the Accounting Standards, may lead the OLSLGR and LGASA to conclude that the general purpose financial reports do not adequately report the operational and financial management of the Council, and to require additional, special purpose reports. It has been our past experience that no additional resources would be provided to assist in meeting such additional requirements.

3. Recognition of Grants Revenues

It follows from the above that we are concerned that grant revenues should be recognised in such manner as to reflect the operational and financial management realities to which they are subject.

In our opinion, the proposals contained in ED 180, while an improvement on AASB 1004 *Contributions,* do not achieve this.

We disagree with the wording in paragraph 21 of the exposure draft, and assert that the "mere specification that ... a transferred asset is required to be consumed in providing goods and services to third parties or be returned to the transferor is," **in itself sufficient** "to give rise to a liability when the entity gains control of the asset."

We note the conflict with the wording of AASB 120.16:

> "It is fundamental to the income approach that government grants be recognised as income on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see AASB 101 *Presentation of Financial Statements*) and would only be acceptable if no basis existed for allocating a grant to periods other than the one in which it was received."

> The development of new accounting standards for not-for-profit entities from PSASB standards does not, in principle, cause us any difficulties. However, because all other IASB standards apply, it is essential that the underlying philosophy embodied in the PSASB standards used for this purpose <u>must</u> match those embodied in the IASB standards.

In our view, the requirement to supply a formal acquittal is *prima facie* evidence of the existence of a condition. In addition, where a grant is paid in relation to a number of reporting periods, the amount of the grant to be recognised as income should be the proportion of the grant that is attributable to each reporting period, irrespective of any potential refund requirement. In such cases, a deferred income account should be set up in accordance with AASB 120.26.

<u>Grants used for the construction of assets</u>

In accordance with the above, grants used for the construction or acquisition of assets should also be recognised according to the above principles. We realise that this is at variance with the commentary in AASB 120.17 where such grants are recognised as depreciation is charged, but consider that there is sufficient difference between local government entities and for-profit entities to more than justify the difference in treatment.

4. Local Government Rates

We refer to item (c) of the specific items for comment listed in the exposure draft, and in particular, to the reference to local government rates. Example 7 (IG14 - IG15) could almost be exactly paraphrased to provide a description of the situation applicable to South Australian rates.

Council rates are a property tax that does not confer any direct entitlement to Council services. Perhaps the most significant difference between the state land tax described in example 7 is that, in the case of a State Government, the tax is collected by a different reporting entity to that which expends the revenue receipts, while for Councils the same entity both collects and expends the revenue.

5. Developer Contributions

The situation regarding the legal status of cash developer contributions paid to a council is not entirely clear in regards to the ability of a council to utilise these for works not directly envisaged at the time of the contribution, and the possibility of refund to the developer.

Under these circumstances, we accept that it will be necessary to account for these contributions on the basis that they form non-exchange transfers without effective stipulations. We accept that this may clash with our desire that accounting treatments reflect the operational and financial management realities of the local government environment, but the amounts of such contributions received by all but a few SA councils, and by SA councils in total in any year, are very much less substantial in amount than in other jurisdictions.

A summary of our responses to the questions asked in the exposure draft are attached as Appendix A.

For further information, please contact

Ms Robyn Dunstall
President
SA LG Financial Management Group Inc.

Alexandrina Council
Ph: (08) 8555 7000
Email: robyn.dunstall@alexandrina.sa.gov.au

APPENDIX A

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

In principle, we have no objection to the use of IPSASs in the development of accounting standards for not-for-profit entities. However, in this instance we are concerned at the clear divergence in underlying philosophy between IPSAS 23 and the main corpus of AASBs as reflected in AASB 120.

(b) whether there are any differences between Australia and New Zealand that would override the Boards' desire for converged Standards for non-exchange transactions

We are unable to offer definitive comment. However, from a local government perspective, we are confident that both jurisdictions would be seeking accounting standards that accurately reflect the operational and financial management realities of their environment.

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

Yes; examples should be clearly identifiable as being directly referable to an Australia/NZ environment.

(d) the definition and treatment of conditions on transferred assets

See main submission.

(e) the treatment of advance receipts

In relation to taxes, we concur. See main submission for treatment of advance receipts of grants.

(f) permitting, but not requiring, the recognition of contributions of services

The Group expressed concerns relating to the reliability of measurement of such contributions, and clearly prefers the option of non-recognition.

(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

Disclosure should only be required where (a) such contributions have been recognised and (b) where material.

(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

No comment: no difficulties were envisaged.

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

No comment: no difficulties were envisaged.

(j) prospective application per the transitional provisions

No comment: not considered.

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

No comment: not considered.

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

No comment: not considered.

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

Not applicable in a local government environment.

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

Not applicable in a local government environment.

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

No comment: not considered.

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

The Group is of the opinion that the proposals would ***not*** be of maximum use to users for the reasons set out in our main submission.

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

The Group is of the opinion that the best interests of the Australian economy would be better served by the provision of accounting statements that accurately reflect the operational and financial realities of the local government environment. These proposals fall short of that aim particularly in the area of grant revenues, as set out in our main submission.