Australian Government

Department of Finance and Deregulation

Reference: RMS09/13191
Contact: Peter Gibson
Telephone: 02 6215 3551
e-mail: peter.gibson@finance.gov.au

Mr Kevin Stevenson
The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VIC 8007

Dear Mr Stevenson Kevin

Exposure Draft 180 Income from Non-exchange Transactions (Taxes and Transfers)

The Department of Finance and Deregulation (Finance) welcomes the opportunity to provide comments on Exposure Draft 180 *Income from Non-exchange Transactions (Taxes and Transfers)* (ED 180). Finance supports the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) comments on ED 180. However, given the topic of ED 180, Finance believes it is appropriate to separately emphasise issues that are of a particular concern to the Commonwealth.

Finance is hesitant to support the proposal in its current form due to the significant level of ambiguity that exists in the ED, especially in regards to the recognition of a liability. This ambiguity has been an issue since the issue of AAS 29 in the 1990's and it is essential that this ambiguity now be removed.

Finance supports the recognition and measurement principles set out in the ED with regards to income received from those non-exchange transactions which have restrictions attached to the transferred asset. However with regards to the accounting for income received from those non-exchange transactions with conditions attached, Finance considers the proposals confusing. At the beginning of the ED (paragraph 18) it states that a liability should be recognised when an asset is transferred with conditions attached without qualification but later in the standard (paragraphs 51 and 56) a liability recognition criteria is identified. Finance is of the view that when an asset is transferred with conditions attached a present obligation is incurred and the liability recognition criteria should be met prior to a liability being recognised.

Finance is of the opinion that a return obligation by itself is not sufficient to recognise a liability and defer the recognition of the income. If this were the case, grants would not be recognised at all until the return obligation had expired, often at the end of the project or activity for which the grant was provided. Finance is of the view that a return obligation is

essential for other conditions to impact the recognition of a liability, because in the absence of a return condition, the transferor has no power to enforce other conditions. Paragraphs 21 and 22 allude to this fact but paragraph 18 states a liability is incurred when an asset is received with a return obligation.

Finance is of the view that the ED needs to make comments on the ability of stipulations to impact an entity's ability to control an asset. Currently the ED is silent on this matter but the liability recognition approach taken in the standard implies that stipulations do not impede an entity's ability to control an asset.

Finance is disappointed that the AASB did not address grantor accounting in the ED. Finance is of the opinion the complicated nature of grantor accounting warrants the inclusion of guidance in the accounting standards.

Finance notes that the requirements within the ED for taxation income contradict current practice for the accounting of State Mirror taxes. The Commonwealth currently does not recognise State Mirror taxes. The Commonwealth imposes the taxes but does not collect them. The States recognise these taxes as they control them. The requirement in the ED in Finance's opinion is inconsistent with the control criteria – used throughout the rest of the ED – with a different test, without explanation why this conceptual departure has been applied and how it is warranted.

Finance supports the election approach taken in the ED for the recognition of contributions of services on the basis that in some cases it would be onerous to quantify what those contributions were, even where material to the entity. However, Finance does not support the requirement to disclose those services received in-kind not recognised, thus agreeing with HoTARAC on this issue.

Finance does not have any concerns with the proposed amendments to the other Australian Accounting Standards as set out in Appendix A of ED 180.

Finance's detailed comments on a number of the proposals are set out in the Attachment.

If you have any queries regarding Finance's comments, please contact Peter Gibson on 02 6215 3551.

Yours sincerely

Tim Youngberry
A/g Deputy Secretary
General Manager, Financial Management Group
7 December 2009

Specific Matters for Comment

Questions for both Australian and New Zealand Constituents

(d) The definition and treatment of conditions on transferred assets.

Finance is of the opinion that the definitions for conditions, restrictions and stipulations on transferred assets are adequate to determine if a stipulation is a condition or a restriction. However, Finance believes that the proposed treatment of conditions on transferred assets is ambiguous and, as such, could result in application difficulties and inconsistent treatments between entities.

It is not clear in the ED if a recipient is required to automatically recognise a liability on the gaining of control of an asset subject to a condition or if the recipient only incurs a present obligation. Paragraph 18 states that a recipient incurs a present obligation when it initially gains control of an asset subject to a condition but it also states that when a recipient initially recognises an asset that is subject to a condition, the recipient also incurs a liability. The illustration in the ED (located after paragraph 33) also supports the notion that a liability is incurred; however paragraph 56 supports the notion that the recipient incurs a present obligation which will only be recognised as a liability if the liability criteria set out in paragraph 51 is met. Finance is of the view that the clarity of paragraph 18 needs to be improved to clearly communicate when a liability is required to be recognised. If the criteria set out in paragraphs 51 and 56 are required to be met before a liability is recognised the AASB may wish to include reference to these paragraphs in paragraph 18.

Finance is also of the opinion that the proposed standard needs to provide comments on if and when a stipulation can impede an entity's ability to control an asset. The liability recognition approach taken in the standard implies that stipulations do not impede an entity's ability to control an asset. Finance is not certain that this is always the case: stipulations could impact an entity's ability to exclude or regulate the access of others to the benefits of an asset i.e. stipulations that require the interest earned on grants before they are spent to be reinvested in a particular programme.

Finance is of the view that the ED does not provide sufficient clarification on return obligations when determining if a stipulation is a condition or a restriction. The ED requires the substance of the terms of the stipulation and not merely its form to be considered to determine if the stipulation is a condition or a restriction. It is stated in paragraph 21 "The mere specification that, for example, 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, not sufficient to give rise to a liability when the entity gains control of the asset." Paragraph 22 states "If past experience with the transferor indicates that the transferor never enforces the requirement to return the transferred asset or other future economic benefits when breaches have occurred, then the recipient entity may conclude that the stipulation has the form but not the substance of a condition, and is, therefore, a restriction. If the entity has no experience with the transferor, or has not previously breached stipulations that would prompt the transferor to decide whether to enforce a return of the asset or other future economic benefits, and it has no evidence to the contrary, it would assume that the transferor would enforce the

stipulation and, therefore, the stipulation meets the definition of a condition". Whilst Finance supports the principle of substance over form these paragraphs imply that it is the requirement of the grantor to recover the asset, whilst in many grant contracts the grantee has a parallel obligation to return the asset and this should be reflected in the proposal.

Australian-specific Questions

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

Finance is of the view that a standard on accounting for income from non-exchange transactions is necessary as the current requirements are inadequate. Due to the high level of ambiguity in the proposals, Finance is not confident that the proposals would advance accounting for income from all non-exchange transactions, in particular grants.

The Boards need to address the level of ambiguity within the proposal plus address the issues they and their constituents noted in their response to IPSAS 23.

Finance is also of the view that the proposals are unlikely to overcome one of the principal present difficulties with recognition of non-exchange revenue, which is that entities often are required to account for non-exchange revenue in a different period to that of the related expenditure. While this is a logical application of the control principle, it results in financial statements that are of dubious usefulness to users, particularly for those not-for-profit entities where such revenue can comprise a significant part of their total revenue. Finance has noted that many entities feel so strongly about this issue that they are prepared to accept an audit qualification rather than comply with the interpretation of the accounting standards.

For this reason Finance has, in the past, supported the ability for "time" to be considered a condition related to recognition of non-exchange revenue. While this will not totally eliminate the problem, it will reduce the incidence, and operates in a way that does not compromise the control principle that is central to the standard.