ICAEW representation

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

ICAEW REP 41/06

REVENUE FROM NON-EXCHANGE TRANSACTIONS

Memorandum of comment submitted in July 2006 by the Institute of Chartered Accountants in England and Wales, in response to the International Public Sector Accounting Standards Board's Exposure Draft 29 'Revenue from Non-Exchange Transactions', published in January 2006.

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales ('the Institute') welcomes the opportunity to comment on Exposure Draft 29 *Revenue from Non-Exchange Transactions*, published for comment by the International Public Sector Accounting Standards Board in January 2006. We have reviewed the Exposure Draft and set out below our response to its proposals.

WHO WE ARE

2. The Institute is the largest accountancy body in Europe, with more than 127,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

MAJOR ISSUES

4. Paragraph 60 of the Exposure Draft states that 'An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.' We agree with this, but it is important to emphasise that both the relevant taxable event criterion and the revenue recognition criteria must be met before taxes can be recognised in the financial statements (as income or as assets).

5. The financial statements should only include as tax income those amounts that are capable of being recognised as income by the reporting entity. No reporting entity should be placed under an obligation to report in the financial statements statistical or economic estimates of the 'tax gap' or tax foregone. Such amounts are always likely to be subject to fundamental uncertainty, such that the reporting entity is unlikely to ever to be able itself to state that accounts containing such estimates give a 'true and fair' view .

6. Compliance with the revenue recognition principles set out in paragraphs 4 and 5 above is important in ensuring that the financial reporting framework supports financial statements that give a true and fair view, such that external auditors will be able to give an unqualified opinion. The alternative could be qualifications repeated over a number of years, with corresponding loss of confidence by users in the financial statements. We point, for example, to the European Court of Auditors' qualification of the accounts of the European Commission for 10 years

in succession. Such long-running qualifications ultimately detract from the effectiveness of financial reporting and from the value of the audit opinion.

RESPONSE TO THE SPECIFIC MATTERS FOR COMMENT

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

7. We agree. In our response to the previous Invitation to Comment (ITC) we emphasised the importance of retaining some form of merger accounting for PSEs. We suggest that the IPSASB should consider the financial reporting of entity combinations in the public sector only when the results of the IASB's business combinations project are known. IFAC and its IPSASB should encourage the IASB to take account of the importance for PSEs of retaining some form of merger accounting when developing its proposals under Phase 2 of the business combinations project.

(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 that these compulsory contributions to social security schemes should be explicitly excluded from the scope?

8. We consider that compulsory contributions to social security schemes should be *included* within the scope of the IPSAS.

(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)

9. We think it would be helpful if the IPSAS specifically addressed these compulsory contributions. We do not suggest that detailed guidance is necessary, but a summary of the principles as they might be applied to these contributions, perhaps with examples, would be helpful.

(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.

10. We are content with the definitions.

(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 recognized separately.

11. We agree.

(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?

12. We agree with the principle and we are content with the analysis in paragraph 20.

(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 and 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.

13. We agree.

(g) Measure assets acquired in a non-exchange transaction at their fair value on initial recognition and amend IPSAS 12, "Inventories", IPSAS 16, "Investment Property" and IPSAS 17, "Property, Plant and Equipment" to be consistent with this requirement (see paragraphs 38 – 39 and the Appendix). IPSAS 12 currently requires inventory to be initially recognized 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.

14. We agree. We further consider that more guidance at a principle level should be provided on how to measure the fair value of assets acquired in a non-exchange transaction.

(h) Require that a liability be recognized 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 derecognized, and revenue recognized. Alternatively, do you consider that the IPSAS should only require the recognition of a liability when it is more likely than not that the condition will not be satisfied (see paragraph BC11)? In addition, are you of the view that the requirements relating to the recognition of a liability in respect of a condition applies equally to depreciable and non-depreciable assets?

15. We agree that conditions attaching to an asset should be recognised as liabilities upon initial recognition of the transferred asset, and treated as set out in the ED. We agree with the analysis in paragraph BC 11 that the alternative could result in premature recognition of revenue.

(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).

16. We agree.

(j) Require a non-exchange transaction that gives rise to the recognition of an asset to also give rise to the recognition of revenue to the extent that a liability is not recognized (paragraph 54). Are there any non-exchange transactions in which it would be appropriate to initially recognize the gross inflow of economic benefits or service potential represented by the asset as revenue even if a liability is also recognized, with the simultaneous recognition of an expense for the liability?

17. We agree.

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

18. We agree.

(l) Not permit the netting of expenses paid through the tax system (see paragraphs 72 – 76) against taxation revenue. Instead such expenses must be recognized 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.

19. We agree. With regard to the reporting of tax expenses on a gross basis, this appears to accord with practice in the UK.

(m) Permit recognition of services in-kind that satisfy the recognition requirements (see paragraphs 99 – 103) and require disclosure of the nature and type of services in-kind received, whether recognized or not (paragraph 107108).

20. We agree although we would welcome more consideration as to when recognition should be encouraged rather than simply permitted.

(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?

21. We agree that a five-year transitional period is acceptable for tax revenue. We do not believe that transitional provisions are necessary for other non-exchange transactions.

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