

Accounting Alert

Analysis of the latest Accounting developments delivered to you via e-mail

AASB Issues Exposure Draft on Financial Reporting by Local Governments

The ED was publicly released on 9 October 2003

The Australian Accounting Standards Board (AASB) has released Exposure Draft (ED) 125 'Financial Reporting by Local Governments'. This *Accounting Alert* provides an outline of the major proposals in the ED.

Overview

As a response to concerns that the requirements in AAS 27 'Financial Reporting by Local Governments' is outdated, the AASB has been working towards an amendment to the existing Accounting Standard on local government reporting.

The AASB has also indicated that the proposals in ED 125 will be used as the basis for a review of the existing requirements in respect of other public sector entities.

Copies of the EDs are available at www.aasb.com.au, with the comment period closing on 28 February 2004.

Key Proposals

Key changes proposed by ED 125 include:

- elimination of many local government specific requirements, so that this sector no longer has a 'stand alone' Standard – other Standards will be used in conjunction with the revised local government Standard
- optional indefinite relief from having to recognise land under roads
- changes to accounting for government restructures by requiring fair value accounting in most cases, and adjusting accumulated surplus/deficit rather than recognising an impact on the net surplus/deficit for the period
- amending the guidance for contributions of assets, resulting in later revenue recognition for certain conditional grants.

Other Public Sector Projects

The proposals in ED 125 are part of, and related to, wider projects in public sector accounting. Therefore, the proposals in ED 125 may be affected by current or future AASB projects on the following:

- convergence issues between Generally Accepted Accounting Principles and Government Finance Statistics
- related parties
- depreciation of infrastructure assets, particularly in a 'mixed measurement environment'.

Feedback and Assistance

We welcome your feedback on the matters covered in this *Accounting Alert* – please email your comments to accounting_alerts@deloitte.com.au.

For assistance in applying the requirements outlined in your organisation, please contact your local Deloitte office or contact our Lead National Technical Partner, Bruce Porter on (03) 9208 7490, or by email to bruporter@deloitte.com.au.

Any resulting Standard will no longer be a 'stand-alone' pronouncement, but will in most instances operate within the set of reporting requirements applicable to other reporting entities, resulting in the elimination of most differences between local governments and for-profit entities

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Appendix: Analysis of the Amended Guidance on Contributions of Assets

Recognition of assets/ liabilities transferred as a consequence of government restructure through accumulated surplus/ deficit

Transfers of Assets on Government Restructuring

Under AAS 27, assets that are transferred across local governments as a consequence of government restructuring are recognised at their carrying value before the transfer, or at their fair value, and reflected through revenue.

Under the ED, these transfers will no longer be reflected through revenue, but will result in an adjustment against accumulated surplus/ deficit, as though the transfer was a distribution to or contribution by an owner. This change will better reflect the surplus/ deficit resulting from the entity's activities rather than as a consequence of a government decision to reallocate responsibilities. The asset transferred should be measured by the local government recipient at fair value unless this would result in undue cost or effort to the local government; in which event, measurement should be at the carrying value of the asset immediately before the transfer.

The transferor government should recognise an adjustment against accumulated surplus/ deficit for the carrying amount of the asset/ liability that was transferred.

General recognition principles for transfers

The ED provides guidance as to the appropriate accounting by local government grantors and grantees for voluntary transfers that are not contributions by owners for transfers that are, and are not, in substance agreements for the provision of goods and services.

Accounting for voluntary transfers that are in substance agreements for the provision of goods and services

A voluntary transfer that is an in substance agreement for the provision of goods and services may be deferred and recognised when goods and services are provided

- where the transfer is made in arrears, assets (liabilities) and the associated revenue (expense) are recognised when control of the goods has been passed, or services have been provided, to the recipient
- where the transfer is made in advance, the entity receiving the transfer recognises a liability, representing the obligation to provide goods or services, for the fair value of the assets received, where the reliable measurement criterion has been met. Revenue is recognised as goods and services are provided to the recipient
- where the transfer is made in advance, regardless of whether the recipient is the provider of the transferor or a third party nominated by the provider, the provider should recognise a prepayment asset, representing the right to receive goods and services, and an associated expense as the goods and services are provided.

Accounting for voluntary transfers that are not in substance agreements for the provision of goods and services

A voluntary transfer that is not an in substance agreement for the provision of goods and services will in certain conditions give rise to liabilities

- where a grant is both unrestricted and unconditional, or restricted only in the purpose of its use or time of its use, on enforcement of the grant, a grantee (grantor) recognises a grant receivable (grant payable) and associated revenue (expense) for the entire amount of the grant
- where a grant is conditional upon a future event, the grantee recognises an asset at the earlier of the date when the granted asset is transferred to the grantee and the date at which grant conditions are satisfied. Where the transfer occurs after the conditions have been met, revenue (expense) and a corresponding asset (liability) is recognised. Where the transfer occurs before the condition is met, an associated liability should be recognised by the grantee only where the transfer gives rise to a present obligation
- where a grant is conditional upon the granted asset being transferred to a third party, the asset may not be controlled by the grantee, and consequently should not be recognised as an asset of the grantee
- where a grant is conditional upon the granted asset being transferred to a third party and the asset is controlled by the grantee, a liability should be recognised representing the obligation to transfer the asset or provide a refund to the transferor. Revenue is recognised as the condition is met.

The grantor reduces its assets when the advance is made and the adjustment is taken against expenses. A contingent asset exists, being the possible return of the asset should the conditions of the transfer not be met

- where a non-financial grant is conditional upon the granted asset being used to provide goods and services to third parties, the grantee should recognise an asset and revenue equal to the fair value of the asset granted when control is gained. An associated liability for the refund of the granted asset is only recognised where the condition is not met.

The grantor reduces its assets when the advance is made and the adjustment is taken against expenses. A contingent asset exists, being the possible return of the asset should the conditions of the transfer not be met

- where a grant is given on the condition that the grantee obtains matching funds from another entity, a grantee should recognise a liability until the condition of the grant has been met. The grantor should reduce its assets when the advance is made, and, where the recognition criterion are met, recognise an associated asset until the condition has been met.

Accounting for Unconditional Involuntary Transfers (Rates)

An unconditional involuntary transfer should be treated like a voluntary transfer that is not an in substance agreement for the provision of goods and services

The ED clarifies that involuntary transfers such as rates are not in substance agreements for the provision of goods and services, and should therefore be accounted for consistent with the accounting for voluntary transfers which are not in substance agreements for the provision of goods and services. The asset (cash or rates receivable) should be recognised by the local government at the time control of the asset is obtained, being the commencement of the rating period or where earlier, receipt of the transferred asset.

Note: The AASB proposed in ED 124 *Request for Comment on IASB Framework for the Preparation of Financial Statements; IAS 18 Revenue; and IAS 20 Accounting for Government Grants and Disclosure of Government Assistance* not to apply the accounting treatment for government grants as specified by IAS 20 to not-for-profit entities. Consequently, the accounting for certain government grants may differ between entities.