

Financial Reporting Advisory Board

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From the Chairman

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Dear Paul

Revenue from Non-Exchange Transactions (Including Taxes and Transfers)

1. The Financial Reporting Advisory Board (the Board) welcomes the opportunity to comment on the proposals set out in the International Public Sector Accounting Standards Board's (IPSASB) Exposure Draft (29) on revenue from non-exchange transactions.

Background to the Board and its interest in non-exchange transactions

2. The Board acts as an independent element in the process of setting accounting standards for government. The Treasury is required by the Government Resources and Accounts Act 2000 to consult the Board on financial reporting principles and standards. The Board exists to promote the highest possible standards in financial reporting by government and to ensure that any adaptations of, or departures from, generally accepted accounting practice are justified and properly explained. The Board reports annually to Parliament about its activities and highlights areas of concern. More detail about the work of the Board can be found on its website at www.frab.gov.uk.

3. The Exposure Draft (ED) tackles the important issue of accounting for taxation revenues. There is no accounting standard that deals with this topic and the Board welcomes this ED and supports IPSASB in its attempt to provide guidance in this area. In the UK the two largest tax collecting departments, the Inland Revenue and HM Customs and Excise, were merged in April 2005 to form HM Revenue and Customs. The 2004-05 Trust Statements of the Inland Revenue and HM Customs and Excise were prepared on an accruals basis and the Trust Statement of the new combined Department will continue to be prepared on an accruals basis. Work on

developing accounting policies on an accruals bases began in 2000. The Board welcomes the proposal in the ED to allow a transition period of five years as this is in line with the UK experience.

The Board's response

4. The Board is highly supportive of the approach taken in the ED, which largely accords with current practice within the UK public sector. There are only two areas where UK practice differs significantly to that proposed in the exposure draft: tax expenses and donated assets.

Tax Expenses

5. The Board is sympathetic to the proposal within the ED that tax revenue is accounted for gross of any tax expenses. In discussing this response, however, the Board recognises that the provision of support through the tax system is complex and differs between jurisdictions. This means it can be difficult to determine exactly what the tax asset is and therefore whether the accounting treatment should be net or gross. The Board believes that more guidance in this area is needed.

6. In the UK, taxation revenues are accounted for net of tax expense (such as tax credits) to the extent that the taxpayer's liability is extinguished in line with the Organisation for Economic Co-operation and Development's (OECD) guidance on tax credits.

7. The terms 'tax expenditure' and 'tax expense' are so similar as to be confusing and the Board suggests that clearer terminology is required if an IPSAS on Non-exchange Revenues is to be readily understood by accounts preparers.

Donated Assets.

8. The ED proposes that revenue will be recognised where assets are provided to the public sector by way of gift. In the UK public sector the value of donated assets is taken to a donated asset reserve. We have no plans to reconsider the treatment of donated assets by the UK public sector.

Fair Value

9. The ED proposes that assets in respect of non-exchange transactions should only be recognised when: "It is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and the fair value of the asset can be measured reliably" (paragraph 31).

10. IPSASB's *Glossary of Defined Terms IPSAS 1 to IPSAS 21* defines fair value as:

The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction.

11. The Board is concerned that the ED provides insufficient guidance on what fair value means in the context of non-exchange revenues. The definition provided in the Glossary of Defined Terms is not particularly helpful and we feel that some further consideration is needed particularly in light of the current international debate on fair value.

12. I attached the Board's response to the specific matters for comment as detailed in the ED.

Yours sincerely
Elwyn

ELWYN EILLEDGE

Approved by the Chairman and signed in his absence

Revenue from Non Exchange Transactions (Including Taxes and Transfers)

International Public Sector Accounting Standards Board Exposure Draft 29

Response of the Financial Reporting Advisory Board on the proposals to:

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

The Board agrees with this proposal.

(b) *Include within the scope of the IPSASB 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?*

The Board believes that compulsory contributions to social security schemes should be explicitly included in the scope of the exposure draft.

(ii) *Do you think that the ED gives enough guidance in respect of 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)*

The Board believes the guidance provided in the exposure draft is sufficient.

(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.*

The Board is content with the definitions except for those relating to 'tax expenditure' and 'expenses paid through the tax system' which the Board believes are so similar as to be confusing.

(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 is recognised separately.*

The Board acknowledges that in theory the components should be recognised separately but questions whether this approach is sustainable in practice.

(e) Include guidance to clarify that restrictions do not give rise to the recognition of a liability on initial recognition of the transferred assets (paragraph 20). Do you agree that restrictions do not give rise to liabilities on initial recognition of the transferred asset?

The Board agrees with this proposal.

(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 paragraph 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.

The Board agrees with this proposal.

(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 paragraph 38 – 39 and the Appendix). IPSAS 12 currently requires inventory to be initially recognised at cost, and IPSAS 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.

The Board agrees with this proposal.

(h) Require that a liability be recognised in respect of an asset transferred subject to conditions upon initial recognition of the transferred asset (paragraph 50). When the condition has been satisfied that liability is reduced, or derecognised, and revenue recognised. 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 recognition of a liability in respect of a condition applies equally to the depreciable and non-depreciable assets?

The Board agrees with this proposal. The Board does not agree with the alternative suggestion that a liability should only be recognised where it is more likely than not that the condition will not be satisfied. The Board takes the view that conditions should only result in the recognition of a liability where the asset provided under a non-exchange transaction is depreciable.

(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).*

The Board agrees with this proposal.

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

The Board agrees with this proposal. The Board knows of no such transactions as detailed above.

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

The Board agrees with this proposal.

(l) *Not permit the netting of expenses paid through the tax system (see paragraph 72 – 76) against taxation revenue. Instead such expenses must be recognised separately on a gross basis. The ED distinguishes between expenses paid through the tax systems and tax expenditure, and notes that tax expenditures are foregone revenue, not expenses.*

The Board has some sympathy with this proposal but, for the reasons set out in the covering letter, believes that this issue is not as straightforward as the ED suggests.

(m) *Permit recognition of services in-kind that satisfy the recognition requirements (see paragraph 99-103) and require disclosure of the nature and type of the service in-kind received, whether recognised or not (paragraph 107 – 108).*

The Board agrees with this proposal.

(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?*

The Board agrees with this proposal.