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Acting Chief Financial Officer  
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Our ref WAFXXX13A-R-AccountingAdviseReport-  
L2012-MPWsky

20 December 2013

Dear Mr Sharma

## **Accounting Advice for Water Authority of Fiji (“the Authority” or “WAF”)**

We appreciate the opportunity to have assisted Water Authority of Fiji in the provision of Accounting Advisory services as set out in our Engagement Letter with you dated 19 December 2013. We set out below our advice for the Authority’s management’s consideration.

As of 20 December 2013, we have completed all services as provided in our Engagement Letter. This deliverable is in final form and supersedes all draft versions of our advice.

### **1 Scope**

The purpose of our Engagement was to provide advice on the Authority’s accounting treatment in relation to amounts billed to customers for water rates and waste water rates. In addition, you have requested advice in relation to the Authority’s accounting treatment in relation to government grants.

The Scope of the Engagement was as follows:

- Advice on the accounting treatment of amounts billed to customers for water rates and waste water rates under International Financial Reporting Standards (“IFRS”); and
- Advice on the accounting treatment of grants received from the Government of Fiji under IFRS.

The Scope excluded the following areas:

- Advice on the tax-effect accounting implications of these transactions.
- Advice on the financial statement disclosures.

### **2 Advice**

Set out below is our advice on the accounting treatment in relation to the above. The advice outlined below must be read in conjunction with sections 3 to 7 below.

## **2.1 Water rates and waste water rates billed to customers**

- In our view, water rates and waste water rates billed to customers are the revenue of the Authority. The Authority's ordinary activities comprise the provision of water supply and waste water services as set out in section 7 of the Water of Authority of Fiji Promulgation 2007 ("the Promulgation"). The Authority enters into contractual arrangements with domestic and commercial customers and provides these services directly to those customers. The Authority invoices its customers for these services and customers remit payment to the bank account specified by the Authority. All fees and charges billed by the Authority to customers are payable by the customer to the Authority. The Authority bears the credit risk if customers do not pay their invoices.
- We understand the Authority has an arrangement with the Fiji Government, in its capacity as the Authority's shareholder, to pay the remittances from its customers into the Government's consolidated bank account. In our view, this should be treated as either a loan to the Government or a distribution to the Government (as the shareholder of the Authority). The specific treatment will depend on facts and circumstances such as any intention to repay the amount.

## **2.2 Government grants**

- In our view, government grants received by the Authority meet the definition of a government grant under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, on the basis that grants are provided by the Government to enable the Authority to meet its operating expenses and capital expenditure requirements for the financial period incurred to enable the Authority to meet its obligations under the Promulgation.
- IAS 20.12 requires government grants to be recognised in profit or loss on a systematic basis over the periods in which the Authority recognises the related costs for which the grant are intended to compensate.
- To comply with IFRS, government grants received for the purpose of meeting operational expenses are to be recognized in profit or loss as the related costs are incurred and recognised as expenses.
- Government grants related capital expenditure should be recorded in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the related asset and released to profit or loss as the related asset is depreciated or amortised.

## **3 Facts, circumstances and assumptions**

Our advice as outlined above has been formed on the basis of the following facts, circumstances and assumptions as provided to us:

### **3.1 Water rates and waste water rates billed to customers**

- The Authority is a Commercial Statutory Authority. It was established under the Water Authority of Fiji Promulgation 2007 to primarily:
  - harvest, treat and reticulate water for supply to customers; and
  - to collect, transport, treat and discharge waste water.
- The Authority enters into contracts to customers directly with domestic and commercial customers to supply water and provide waste water services.
- These services are provided to customers directly by the Authority using its own assets and resources.
- The Authority invoices customers on a quarterly basis following the provision of the water supply services and waste water services. Billing is based on recorded metered usage by the customer and published unit rates set and regulated by the Commerce Commission of Fiji.
- All remittances from fees, charges and levies of the Authority are paid directly into a bank account nominated by the Authority. We understand the Authority currently has an arrangement with Government (as the Authority's shareholder) such that all remittances are paid directly into the "Consolidated Fund Account – Water Authority of Fiji". We understand that the Authority does not have access to these funds once banked. Third party payment mechanisms, such as Post Shop, also pay customer remittances directly into the same nominated bank account.
- The Authority's current accounting treatment: upon billing the customer the Authority records a receivable with a corresponding entry to recognize revenue. When remittances are received from customers, the receivable is credited. Because the remittances are paid directly into the consolidated account that "belongs" to the government, the Authority records a debit in an equity account to reflect the distribution to government.

### **3.2 Government grants**

- The Authority receives grants from the government to fund its operating and capital expenditure that is incurred in meeting its obligations under the Promulgation.
- The Authority prepares an annual corporate plan that is required to be approved by the Minister of Finance prior to the release of government grant funding. The corporate plan includes the forecast profit and loss, balance sheet, capital expenditure requirements and cash flow statements for the financial period.
- Grants received were previously accounted for by the Authority in accordance with IAS 20.12.

- On 14 March 2013, the Government issued a circular requiring State Owned Enterprises to treat the grants received as a capital contribution.

#### **4 Issue raised by the Office of the Auditor General**

In your email to us dated 21 November 2013, you advised us that the Office of the Auditor General has raised the following issue:

##### ***Water rates and waste water rates billed to customers***

"The Authority has recorded revenue from water charges and sewage charges in the income statement. However, the cash collected from the customers goes directly into the consolidated fund of the Government. The Authority has no control over the cash or the bank account. Accordingly, this is not in line with International Accounting Standard (IAS 18). IAS also states that collection on behalf of a third party or a principal (in case of Authority the Government) is a revenue. Consequently, revenue and receivables are not fairly stated in the financials."

##### ***Government grants***

"The Authority records operating grants as equity. This is not in line with IAS 20 which requires an operating grant to be recorded as income to match the related costs. This is not in accordance with the conceptual framework "Matching concept principle" either. The cost needs to be matched with the revenue it is financed from."

#### **5 Relevant literature**

Our advice as outlined above has been formed with reference to:

- IAS 18 *Revenue*
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

#### **6 Analysis**

The analysis that supports our advice as outlined above is as follows:

##### ***6.1 Water rates and waste water rates billed to customers***

IAS 18 defines revenue as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. [IAS 18.7]

IAS 18.8 goes on to say "Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not

economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission."

The Authority's ordinary activities comprise the provision of water supply and waste water services as set out in section 7 of the Water of Authority of Fiji Promulgation 2007. The Authority enters into contractual arrangements with domestic and commercial customers and provides these services directly to those customers. The Authority invoices its customers for these services and customers remit payment to the bank account specified by the Authority. All fees and charges billed by the Authority to customers are payable by the customer to the Authority. The Authority bears the credit risk if customers do not pay their invoices.

The Authority invoices customers on a quarterly basis following the provision of the water supply services and waste water services. Billing is based on recorded metered usage by the customer and published unit rates set and regulated by the Commerce Commission of Fiji.

**In our view, water rates and waste water rates billed to customers are the revenue of the Authority. The fact that the Authority has nominated that customer remittances are paid into a Government account does not mean these amounts are collected on behalf of Government or suggest an agency relationship.**

There is no indication that the Authority is acting on behalf of a principal where revenue collected is for the principal. Assets used in the ordinary course of business of generating revenue are held on the Authority's balance sheet. While all customer remittances are banked in to the government's consolidated account, the use of the consolidated account would appear to be an agreement between the Authority and its shareholder to assist with the Government's cash flows rather than the cash receipts representing the Government's revenue from the provision of these services.

IAS 18.20 states that when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. IAS 18.20 specifically states that the outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

Conditions	Comments
(a) the amount of revenue can be measured reliably;	Amount is based on metered usage multiplied by published rates. Accordingly, revenue can be measured reliably.
(b) it is probable that the economic benefits associated with the transaction will flow to the entity;	Assuming the customer is considered credit worthy, the customer remits payment to a bank account nominated by the Authority. Accordingly this condition is met.
(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and	Customers are billed in arrears on completion of the services for the billing period. Accordingly this condition is met.
(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.	The Authority is able to determine and record the related costs as they are incurred. Accordingly this condition is met.

The Authority determines how proceeds from fees and charges are to be remitted by customers. In this case, it has specified that all customer remittances are to be paid into the consolidated account belonging to Government. The Promulgation does not specify whose bank account remittances are to be paid into. We are not aware of any contractual or legal restriction on the Authority to prevent it from changing the current banking arrangements.

The banking of customer receipts directly into the Government’s account raises the question of whether this constitutes a loan or a distribution to the Government in its capacity as the Authority’s shareholder. **In the absence of any formal loan agreement or intention to repay these amounts, our view is that the remittance of receipts into the Government’s consolidated bank account is a distribution to Government as the Authority’s shareholder.**

## 6.2 Government grants

IAS 20.3 defines government grants as assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.

In our view, the government grants received by the Authority meet the definition of a grant in that they constitute government assistance provided to enable the Authority to meet its operating expenses and capital expenditure for the financial period based on the approved annual corporate plan.

IAS 20.8 states that a government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. In the Authority's case, grants are awarded following submission of a detailed forecast plan and the grant is expected to be spent on these planned expenses, that are incurred in meeting the Authority's obligations under the Promulgation.

IAS 20.12 specifically requires that government grants are recognised as income over the periods in which the related costs which they are intended to compensate are recognised, on a systematic basis.

Government grants related to assets, are required to be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset and released to profit or loss as the underlying asset is depreciated or amortised (IAS 20.24-27).

Given the Government is also the shareholder of the Authority, it is important to distinguish a government grant from a contribution from Government acting as the shareholder of the Authority. In this case, we understand the grants are largely provided to subsidise loss making services provided by the Authority and to fund capital expenditure to enable it provide the services it is required to provide under the Promulgation. These grants are based on annual approved operating plans and not ad-hoc financing transactions akin to equity contributions by shareholders of commercial organisations. Based on this, our view is that the Government is providing grants in its capacity as the Government and not as the shareholder of the Authority.

Based on our analysis of the facts and circumstances above, by following the Government's circular requiring the Authority to treat the government grant received as a capital contribution, the Authority is not in compliance with IAS 20.

## **7 Basis of advice**

### ***Inherent limitations***

This deliverable has been prepared at the request of Water Authority of Fiji in accordance with the terms of our Engagement Letter dated 19 December 2013 and based on the Scope outlined in section 1 above. The ultimate responsibility for the accounting treatment of any matter rests with the preparers of the financial statements, including Water Authority of Fiji's directors and management.

The services provided in connection with this engagement comprise an advisory engagement, which is not subject to auditing, review or assurance standards issued by the International Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed. Any reference to 'review' throughout this deliverable has not been used in the context of a review in accordance with auditing, review or assurance standards issued by the International Auditing and Assurance Standards Board.

The advice provided in this deliverable is based upon the facts and circumstances provided to us and the assumptions you have advised we should make, as outlined in section 3 above. The Authority is responsible for ensuring:

- the facts, circumstances or assumptions regarding the issues noted do not differ from those provided to us; and
- complete and accurate information has been provided to us, including details of other contracts or arrangements, whether documented or orally agreed, which impact upon the overall substance of the subject matter.

If the Authority has not fulfilled these responsibilities, our advice may not be valid. We have not sought to independently verify any information provided to us.

The advice in this deliverable is based on interpretations of accounting standards and other relevant professional pronouncements and legislation current at the date of preparing the advice, as outlined in above. Should the accounting standards, other relevant professional pronouncements or legislation change, the advice may not be valid.

#### ***Third party reliance***

This deliverable is solely for the purpose set out in the Scope section and for the Authority's information, and may not be used for any other purpose or provided or distributed to, or accessed or relied upon by, any other party without KPMG's express written consent. Other than our responsibility to the Authority, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this deliverable. Any reliance placed is that party's sole responsibility.

We understand that this deliverable may be provided to the Authority's external auditor. The Authority's external auditor is not a party to our advice with the Authority and our engagement was neither planned nor conducted in contemplation of the purposes for which the Authority's external auditor may access this deliverable. The Authority's external auditor is responsible for forming their own audit opinion. Accordingly, The Authority's external auditor may not place reliance on this deliverable. KPMG is not liable for any losses, claims, expenses, actions, demands, damages, liabilities, or any other proceedings arising out of any reliance by the Authority's external auditor on this deliverable.



## **8 Closing**

Please contact Michael Yee Joy or me if you have any questions. We thank you and the relevant the Authority personnel for all the assistance providing in conducting this engagement and we look forward to continuing to provide service to your organisation.

Yours Sincerely

A handwritten signature in blue ink, appearing to read 'M Webb'.

Matthew Webb  
Partner