



Staff Paper

Project:	Not-for-profit public sector entity licences	Meeting	AASB June 2017 (M158)
Topic:	Preliminary project scope	Agenda Item:	8.1
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Introduction and objective of this paper

- 1 The objective of this paper is to outline a number of accounting treatment options for revenue from licences granted by a public sector entity with a view to obtaining board direction on which options would be suitable for further consideration.
- 2 This paper is structured as follows:
 - (a) background to the project and past board considerations (paragraphs 4-12);
 - (b) staff analysis of the existing accounting standards and their possible application to public sector NFP entities (paragraphs 13-32);
 - (c) NFP standard-setting framework considerations (paragraphs 33-38); and
 - (d) options for progressing with the project (paragraphs 39-40).

Summary of staff recommendations

- 3 The staff recommend the following:
 - (a) confirm the scope of the project to the accounting of revenue from licences granted by public sector NFP entities; and

- (b) modify Australian Accounting Standards to address the accounting for in-substance non-intellectual-property licences granted by public sector NFP entities, subject to further consideration of the chosen options.

Background

- 4 The Board previously discussed licences granted by public sector NFP entities as part of its Income of Not-for-Profit Entities and Service Concession Arrangements: Grantors projects. In both instances, the Board precluded its deliberations in favour of a specific project to research the extent to which these types of licences exist, as well as the current and potential accounting treatment.
- 5 Consequently, as part of the Board's 2017-2019 Agenda Consultation, staff presented a project plan to address the accounting for intangible assets of public sector entities, including addressing the accounting for licences granted by public sector entities.¹ The Board decided to add to its 2017-2019 Work Program a project on accounting for revenue from licences granted by public sector NFP entities.
- 6 In past deliberations,² the Board considered whether the application guidance in AASB 15 *Revenue from Contracts with Customers* (set out in AASB 15.B52 to AASB 15.B63) could be applied directly or by analogy to licences granted by public sector NFP entities. However, the Board was unable to form a view, primarily due to the guidance being applicable to licences of intellectual property (IP) only.³
- 7 The International Accounting Standards Board (IASB) did not provide a rationale for only providing guidance limited to IP licences in the Basis for Conclusions to IFRS 15 *Revenue from Contracts with Customers*, nor any of its preceding consultation documents. Staff reached out to former IASB staff who worked on the project, and were informed that the IASB was made aware of licences issued by public sector entities (specifically spectrum licences), however indicated the IASB retained its limited scope as it would be unlikely that a for-profit entity would grant a licence to an asset other than IP, and that public sector specific licences would be best addressed by the IPSASB.
- 8 The IPSASB has commenced a project to develop a new standard covering revenue transactions of public sector entities; however IPSASB staff noted that the project has not yet progressed to a stage where licences have been discussed. Staff will continue to monitor the progress of this project.
- 9 Preliminary outreach undertaken by staff identified a number of licences being granted by NFP public sector entities. Table 1 sets out examples of the licences identified and the current accounting treatment adopted based on discussions with constituents. The preliminary view of staff is that most, if not all, of these licences would not be IP

1 [Link to agenda paper 3.2 of May 2017 AASB meeting.](#)

2 [Link to agenda paper 3.9 of August 2016 AASB meeting.](#)

3 See paragraph 22 of this paper for examples of IP licences that would fall under AASB 15.

licences as, based on general definitions, ‘intellectual property’ is a creation of an entity in the form of process(es) and/or knowledge. However, staff acknowledge that determining whether a licence is within the scope of AASB 15 is subject to the specific facts and circumstances of the licence and more research would need to be done to determine if there are licences granted by public sector NFP entities that would be IP licences.

Table 1: Examples of licences granted by NFP public sector entities

Type of licence	Current accounting
Fishing licence	Up-front revenue recognition
Drivers licence	Up-front revenue recognition
Gaming licence	Over-time revenue recognition
National park licence	Up-front revenue recognition
Taxi licence	Up-front revenue recognition
Liquor licence	Up-front revenue recognition
Wildlife harvesting licence	Up-front revenue recognition

- 10 Staff are also cognisant that as part of this project, more research would need to be done to consider other types of licences (such as bed licences and mineral/water rights) and whether there are non-IP licences granted by public sector NFP entities that would be within the scope of AASB 15. For example, even if a licence granted by a public sector NFP entity is not an IP licence, it could be within the scope of AASB 15 by virtue of the fact that it is a “contract with a customer” that is not a statutory requirement and there are sufficiently specific rights and obligations. Consideration may also need to be given to other arrangements such as permits and whether guidance should be provided on how to account for revenue from such arrangements.
- 11 In respect of other related projects, as part of its Income of Not-for-Profit Entities project, the Board deliberated regarding the inclusion of licences in the scope of AASB 1058. Agenda paper 3.9 of the August 2016 AASB meeting noted that targeted outreach by staff indicated accounting for public sector licences was a significant issue, stating, “constituents expressed the view additional guidance is required for determining whether revenue is recognised over time or at a point in time for licences providing the right to operate in a particular jurisdiction(s) and/or for a particular purpose(s), such as gambling licences”.⁴ The Board decided to exclude licences

4 [Link to agenda paper 3.9 of August 2016 AASB meeting.](#)

(outside the scope of AASB 15) from the scope of AASB 1058, in favour of a broader project on the topic.⁵

- 12 Pursuant to decisions made at the Board's August 2016 meeting, entities are precluded from applying AASB 1058 to licences outside the scope of AASB 15 subject to the completion of this project. Staff will continue to monitor the interaction between the recommendations arising from this project and the requirements of AASB 1058.

Staff analysis

Project scope

- 13 As part of its Service Concession Arrangements: Grantors project, the Board considered whether AASB 15, including its application guidance on licences of IP, could be used (by analogy under the circumstances that the intangible asset created by the licence is not considered to be IP) to account for a public sector entity granting an intangible asset to an operator (representing a 'right to charge users') in exchange for the construction of a service concession asset and the provision of related future services.⁶ However, the Board considered that the arrangement to grant the intangible asset would not be a contract with a customer within the scope of AASB 15, given that the granting of the right to charge users is in the nature of financing the construction of a service concession asset and as such would not be an output of the public sector entity's ordinary activities. Consequently the Board decided to create specific requirements for service concession assets, which, in the circumstances identified above, would require the grantor to:
- (a) initially recognise an obligation (instead of immediate revenue recognition) when the service concession asset is recognised; and
 - (b) subsequently recognise revenue over the life of a service concession arrangement.
- 14 Staff also note that the Service Concession Arrangements: Grantors project requires the grantor to recognise service concession assets which are internally generated (which previously were unable to be recognised) at current replacement cost, overriding the requirements of AASB 138 *Intangible Assets*. Staff think that the scope of this project should be limited to considering the accounting for the revenue of licences granted by public sector entities and not extend to the recognition of the underlying assets giving rise to the licences due to:
- (a) the need to complete this project in time for the mandatory application date of AASB 15 for NFP entities and AASB 1058 (1 January 2019). Otherwise, entities might be applying the requirements in AASB 15 or AASB 1058 for licences by analogy when the Standards become mandatory without sufficient guidance and this could give rise to further diversity in practice; and

5 [30-31 August 2016 AASB meeting minutes, agenda item 3.](#)

6 [Link to agenda paper 15.3 of September 2014 AASB meeting.](#)

- (b) the scope of AASB 15, which only extends to the recognition of revenue, and not to the underlying asset giving rise to the licence;

If the scope of this project is extended to the accounting for the underlying asset giving rise to the licencing arrangement of public sector NFP entities, the considerable research, outreach and analysis needed to address this, (for example when a fishing licence is granted, to what extent a jurisdiction can recognise waterways and contained wildlife as an asset) would put at heightened risk the possibility that this project would not be completed in time for the mandatory application of AASB 15 for NFP entities and AASB 1058.

- 15 Accordingly, staff recommend that the scope of this project be limited to the accounting for revenue from licences granted by public sector NFP entities.

Question to Board members

Do Board members agree to limit the scope of this project to the accounting for revenue from licences granted by public sector NFP entities?

Possible existing accounting treatment options for revenue from licences granted by a public sector NFP entity

- 16 Preliminary outreach shows that public sector entities tend to issue both licences and permits. For example, the Victorian Government issues both driver's licences and learner's permits. Initial staff view is that the Board may wish to consider whether guidance is necessary to distinguish between the two terms as the Board did with AASB 1058 regarding memoranda of understanding and contract.
- 17 The term 'licence' is not explicitly defined in Australian Accounting Standards, however, staff consider that further outreach with NFP public sector entities would be necessary to distinguish between licences from 'permits' as this may affect the project scope.

Licences within the scope of AASB 15

- 18 AASB 15 sets out the accounting treatment that entities should adopt with respect to recognising and measuring revenue from contracts with customers. In the specific context of licences, AASB 15 may be applicable to the accounting for revenue derived by the entity in respect of the grant of a licence, to the extent that the licencing arrangement falls within the scope of AASB 15.
- 19 Staff note that revenue from the sale of the asset underlying the licence could be accounted for in accordance with AASB 15, but depending on facts and circumstances, another Australian Accounting Standard (e.g. AASB 116 *Property, Plant and Equipment* or AASB 138) might apply.

- 20 Broadly, to fall within the scope of AASB 15, the revenue generated by either the grant of the licence or from the sale of the underlying asset should satisfy the relevant requirements set out in AASB 15 such that:
- (a) the grant of the licence or sale of the asset is underpinned by a contract with a customer (as per the requirements in paragraph 9 of AASB 15⁷) that is enforceable;
 - (b) the contract contains a promise(s) representing sufficiently specific rights and obligations;⁸ and
 - (c) the contract arises from a customer obtaining goods or services that are an output of the entity's ordinary activities in exchange for consideration.
- 21 In addition, in the case of IP licences, the application guidance in AASB 15 (set out in AASB 15.B57 to AASB 15.B62) would be relevant in determining the pattern of revenue recognition for such licences. Specifically, it is necessary for the entity to determine the nature of the right provided to the customer and to determine whether the entity's promise to grant the licence provides the customer with a right to:
- (a) use the entity's IP (which would result in revenue recognition at the point in time when licence is granted); or
 - (b) access the entity's IP (which would result in revenue recognition over time).
- 22 AASB 15 does not explicitly define the meaning of the term 'intellectual property'. AASB 15 does however, set out examples of items that would fall within the scope of the Standard. AASB 15.B52 states:
- "Licences of intellectual property may include, but are not limited to, any of the following:*
- (a) software and technology;*
 - (b) motion pictures, music and other forms of media and entertainment;*
 - (c) franchises; and*
 - (d) patents, trademarks and copyrights."*

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- 7 AASB 15.9 requires a contract with a customer to meet all of the following criteria for a contract with a customer to be within the scope of AASB 15:
- (a) mutual approval of the contract and commitment to perform the respective obligations;
 - (b) identification of each party's rights;
 - (c) identification of the payment terms;
 - (d) commercial substance; and
 - (e) probability that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.
- 8 Subject to the arrangement not being scoped out by AASB 15 as it is covered by another standard (e.g. leases).

- 23 In this regard, IP licences and possibly some non-IP licences that are contracts with customers would fall within the scope of AASB 15.

Licences outside the scope of AASB 15 and the application of AASB 16 Leases

- 24 AASB 16 sets out the accounting for leases. At the inception of a contract, entities are required to assess whether the contract contains a lease such that the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Accordingly, it is necessary to consider whether the accounting for revenue from a licence could fall within the ambit of AASB 16 with the licensor (public sector entity) being the lessor.
- 25 To the extent the licence pertains to IP, AASB 16.3(d) states that such licences should be accounted for in accordance with AASB 15. Therefore, licences pertaining to items other than IP could fall within the scope of AASB 16 if the arrangement could be regarded as a lease, which is a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
- 26 To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
- (a) the right to obtain substantially all of the economic benefits from the use of the identified asset; and
 - (b) the right to direct the use of the identified asset.
- 27 AASB 16.B13 describes an identified asset as one explicitly or implicitly specified at the time the asset is made available for use by the customer. AASB 16.B20 states that a capacity portion of an asset is an identified asset if it is physically distinct. A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.
- 28 In the case of the accounting for revenue from a licence granted by a public sector NFP entity (i.e. lessor perspective in a lease), staff's preliminary view is that most of these licences do not explicitly or implicitly identify an underlying asset at the time a licence is granted to a customer. Furthermore, in the event an asset is identified, staff consider that a licence is highly unlikely to satisfy both of the requirements outlined in paragraph 26 above as the licensor would most likely retain the ability to direct the use of the underlying identified asset during the period of the licence. Accordingly, preliminary assessment by staff is that it is unlikely that AASB 16 would apply to the accounting for licences falling outside the scope of AASB 15.

Types of licences outside the scope of AASB 15

- 29 Staff conducted outreach to understand the specific nature of various licence arrangements in the public sector that could fall outside the scope of AASB 15. Staff conducted discussion based outreach with the following public sector constituents:
- (a) Queensland Department of Treasury;

- (b) Victorian Department of Treasury and Finance (DTF); and
- (c) Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC).⁹

- 30 Staff findings identified a number of licence arrangements that could be outside the scope of AASB 15. The key reason why the licence arrangements identified would not fall within the scope of AASB 15 is that the arrangements are not entered into by way of contract but by statutory requirements although the arrangements confer performance obligations to the licensor.
- 31 Staff considered the licence arrangements discussed during initial outreach and considered these against the requirements set out in AASB 15. This analysis is set out in Table 2 below.

Table 2: Summary of licence arrangements outside the scope of AASB 15

Relevant recognition criteria per AASB 15	Drivers licence	Gaming licence ¹⁰	Building and contractor licence
Is there a <u>contract</u> with a <u>customer</u> in respect of the licence?	Further research required	Likely	Further research required
Does the licensor have a <u>performance obligation</u> ?	Yes on initial assessment	Yes on initial assessment	Yes on initial assessment
Is there a promise to transfer either a <u>distinct good or service</u> , or a series of distinct goods or services to a customer (such as to deliver a licence)?			
Does the licence establish a right to <u>intellectual property</u> ?	No	No	No
Is the arrangement a licence ¹¹ in substance?	Yes	Yes	Yes

9 Comments from HoTARAC were not received in time to be reflected in this Board paper, however Staff intend to provide the Board with a verbal update.

10 Based on preliminary outreach conducted with the DTF, the pricing of Victorian gaming licences is subject to individual negotiation between the gaming entity and DTF based on variables such as expected revenues and number of gaming tables.

11 The *Marriam-Webster Dictionary* defines the licence as “a permission granted by competent authority to engage in a business or occupation or in an activity otherwise unlawful.” In the absence of a definition in Australian Accounting Standards, staff have used the *Marriam-Webster Dictionary* definition to explore whether the arrangements could be in-substance licences.

Relevant recognition criteria per AASB 15	Drivers licence	Gaming licence ¹⁰	Building and contractor licence
Does the licence represent a <u>right of access</u> or a <u>right of use</u> ?	Further research required	Further research required	Further research required

- 32 AASB 15 only considers licenses of IP. As noted above, some public sector arrangements appear to be licences in substance but are not IP licences. Although some of the non-IP licence arrangements could still be in the scope of AASB 15 (i.e. the arrangements are ‘contracts with customers’ that are not specifically scoped out by AASB 15), there is no specific guidance in AASB 15 to account for revenue from these arrangements. There could also be licences granted by public sector entities that would not be within the scope of AASB 15 (for example because they arise from statutory requirements). It is highly likely that most of the non-IP licence arrangements would not be within the scope of AASB 16 for the reasons articulated in paragraph 31. Other Australian Accounting Standards do not have specific guidance on accounting for revenue from licences. Therefore there is currently no specific guidance or requirements in Australian Accounting Standards in relation to accounting for revenue from non-IP licences.

Question to Board members

Q1 Do Board members agree that accounting for revenue from non-IP licences are not specifically addressed by Australian Accounting Standards although some of these arrangements could be within the scope of AASB 15 and some of these arrangements could be outside the scope of AASB 15?

Q2 Do Board members agree that further analysis is required to distinguish between licences from permits?

NFP standard-setting framework

Why should the Board consider modifications?

- 33 The Board’s draft NFP standard-setting framework establishes the criteria the Board needs to consider before modifying an IFRS Standard for NFP-specific issues. In this respect transaction neutrality is used as a starting point, and is then modified as necessary to address user needs, prevalence and magnitude of issues specific to the NFP sector, NFP application issues and public interest issues relevant to financial reporting and undue cost or effort considerations.
- 34 Regarding NFP public sector licensing arrangements, the primary factor contributing to a need for modification is the prevalence and magnitude of NFP issues affecting reported performance, such as:
- (a) non-contractual and non-IP licence arrangements;

- (b) quantum of licence arrangements; and
- (c) terminology differences where some arrangements may be labelled as licences but the economics of the transaction might not reflect a licence (for example, in the guidance the Board added to AASB 1058 it was made clear that a ‘contract’ could include other arrangements that may not be labelled as contracts), or in some jurisdictions both driver’s licences and learner’s permits are issued, where one might argue the substance is the same.

35 In addition, current Australian Accounting Standards do not specifically address accounting for revenue from non-IP licences (arising from a contract or statutory requirement) and even in the case of IP licences, which are addressed in AASB 15, there might be a need to provide further guidance on the accounting for IP licences by public sector NFP entities due to fact that AASB 15 is written from a for-profit entity perspective.

Are the issues identified sufficiently significant to warrant NFP-specific modification?

36 Both federal and state / territory governments issue non-IP licences. Examples include:

- (a) driver’s licences;
- (b) liquor and gaming licences; and
- (c) national parks usage licences.

37 In Victoria, revenue collected from licences accounts for \$5.5 billion of the State's combined \$64.7 billion (8.7%) of revenue. As highlighted above, this revenue is only from a small number of licences issued by the State among many others (as identified in table 1). Therefore, licencing revenue would, in aggregate, represent a significant portion of a government’s revenue.

38 If addressed, any modifications the Board proposes to Australian Accounting Standards will significantly contribute to increased internal consistency within Australian Accounting Standards as modified for NFP entities in relation to accounting for revenue from licences granted by public sector NFP entities. Given the nature and magnitude of the accounting issues identified, staff recommend the Board modify Australian Accounting Standards, which might include NFP specific requirements, guidance and examples, to clarify the accounting for revenue from licenses granted by public sector entities.

Question to Board members

Does the Board agree with the staff recommendation to modify Australian Accounting Standards to include NFP-specific requirements, guidance and examples, to clarify the accounting for revenue from licenses granted by public sector entities?

Options to address constituent's concerns

- 39 On the assumption that the Board agrees to modify Australian Accounting Standards to provide specific requirements and guidance to clarify the accounting for revenue from licenses granted by public sector entities, staff consider the following options are available:
- (a) clarify that all licences (IP and non-IP) granted by public sector NFP entities (including those arising from statutory requirements) are within the scope of AASB 15 and the guidance in AASB 15 to account for revenue recognition of IP licences would also apply to non-IP licences issued in the public sector. However, entities would have to consider whether the licences grant a right to use or right to access in determining the pattern of revenue recognition. Additional clarifications would nonetheless be necessary (such as application guidance and illustrative examples);
 - (b) clarify as in (a) above, but specify that public sector licences would all be treated as right-to-access licences, or right-to-use licences; or
 - (c) provide separate accounting guidance (outside AASB 15) specifically to account for revenue from licences of public sector NFP entities (contractual and statutory); or
 - (d) provide guidance in AASB 15 for revenue from licence arrangements within the scope of AASB 15 (choosing either the option (a) or (b) and provide separate accounting guidance (outside AASB 15) to account for revenue from licences of public sector NFP entities arising from statutory requirements;
- 40 Staff have not identified other options that the Board could consider. At this stage staff are of the view that either option (a) or (b) above would be the most feasible based on the timeframe within which the guidance needs to be issued. However, the purpose of this paper is to obtain Board views on whether any other options need to be investigated. Assuming the Board agrees with one or more of the above options for consideration, future meetings will explore the technical merit of the options identified and seek Board input at the relevant stages.

Questions to Board members

Q1 Are there any other accounting options the Board thinks need consideration?

Q2 If no, does the Board have a preference for staff exploring any one or more of the options identified in the paper?