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The Chair
Australian Accounting Standards Board
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11 March 2022

Dear Sir

ED 318 – ILLUSTRATIVE EXAMPLES FOR INCOME OF NOT-FOR-PROFIT ENTITIES AND RIGHT-OF-USE ASSETS ARISING FROM CONCESSIONARY LEASES

Thank you for the opportunity to comment on the Board's proposals regarding Exposure Draft ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases*.

We support the Board's proposals for its approach regarding concessionary leases. However, we do not support the proposed additions and amendments to illustrative examples contained in AASB 15 and AASB 1058. We would prefer these issues be dealt with as part of the Board's post-implementation review.

Please refer to Appendix 1 for our detailed comments on your specific matters for comment, Questions 1 to 5.

If you have any comments regarding this request, please do not hesitate to contact me.

Yours faithfully

ABoshoff

Aletta Boshoff
Partner

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APPENDIX 1 – Specific matters for comment

Question 1

Do you agree that the proposed amendments to the AASB 15 and AASB 1058 illustrative examples provide appropriate illustration of the application of the recognition and measurement requirements of the Standards? If not, please explain why.

BDO Comment - Proposed Examples 3A.1 and 3A.2 to AASB 1058

We do not support the proposed amendments to illustrative Example 3 in their current form because the fact pattern is overly detailed and unlikely to occur in practice. We therefore question the usefulness of the example to preparers of not-for-profit financial statements.

While we acknowledge that the purpose of Example 3 is to illustrate a scenario where an endowment could result in the university recognising a financial liability on initial recognition (rather than income under AASB 1058.10, or a contract liability under AASB 15), we consider the fact pattern, analysis, and conclusion to be unnecessarily complicated.

After attempting a 'line-by-line' markup to suggest improvements to the proposed wording in Example 3 and 3A.1, we concluded that there were too many different aspects that raised questions or challenges that we could not easily address via detailed suggestions to amend the proposed wording. We would therefore prefer a more thorough consideration of some of the issues raised as part of the post-implementation review, and that the Board not adopt these amendments to illustrative Example 3.

The following issues/challenges have been identified with the proposed wording in Example 3 and 3A.1:

- Analysis of why the university recognises a financial asset is unnecessarily complicated
- Reference for measuring the financial liability on initial recognition
- Commentary in the 'Accounting Treatment' section regarding AASB 1058.B13
- Presentation in profit or loss
- What if the financial liability is not repayable on demand?

These are discussed further below.

If the Board considers it imperative to clarify Example 3 in the short-term, perhaps a simpler, more realistic example could suffice. For example, a university receives a $2 million grant which is tied to a particular researcher. The university must administer the outflow of funds at the request of the researcher, and pay any outstanding balance onto any subsequent employer of the researcher. Such an example would result in a financial liability for the university, with a less complicated analysis to explain the accounting treatment for the recognition and measurement of the financial asset and the financial liability (the financial liability would also be on demand because the research would be able to spend the funds immediately).

Analysis of why the university recognises a financial asset is unnecessarily complicated

The second and third paragraphs of the discussion/explanation (refer extract below) address why the university recognises a financial asset (cash). We do not consider it necessary for University A to consider whether it has a 'pass-through arrangement' under AASB 9.3.2.5 because there is no indication in the fact pattern that a ‘pass-through arrangement’ was contemplated. The cash scholarships are provided as and when the alumnus determines, so there is no requirement for University A to immediately remit cash scholarships without material delay (AASB 9.3.2.5(c)). Many preparers would therefore not find this analysis helpful in practice.

> “Based on the facts and circumstances outlined above, as the principal amount must be applied towards funding cash scholarships at the direction of the alumnus over the next 10 years, the university considers whether it has incurred should recognise a financial instrument (i.e. a financial liability) under AASB 9 as a related amount. The university also considers whether derecognition of the financial asset is appropriate under Chapter 3 ‘Recognition and derecognition’ of AASB 9, instead of the recognition of a financial liability.
>
> As the university agreed to apply the endowment towards cash scholarships at the direction of the alumnus, the university considers whether it has transferred the financial asset to scholarship recipients.
>
> The university notes that because it did not assume an obligation to pay cashflows from the asset that meets the conditions in AASB 9 paragraph 3.2.5 (i.e. it did not enter a ‘pass-through arrangement’) and it has retained substantially all the risks and rewards of the asset as it may invest the funds as it considers appropriate, the university continues to recognise the financial asset in accordance with AASB 9 paragraphs 3.2.1-3.2.9.
>
> The university also determines that the endowment gives rise to a financial instrument and, specifically, a financial liability because:
>
> - the endowment constitutes a contractual obligation to deliver cash or another financial asset to another entity, being the obligation to apply the principal to cash scholarships for eligible students under the direction of the alumnus (AASB 132, paragraph 11); and
> - the university does not have an unconditional right to avoid delivering cash to settle this contractual obligation (AASB 132, paragraph 19).
>
> Accordingly, the university continues to recognise the endowment funds as a financial asset and recognises the endowment principal as a financial liability as required by paragraph 3.2.15 of AASB 9.”
>
> **Extract of Proposed Example 3A.1 (discussion)**

If the Board nevertheless decides to publish revised Examples 3 and 3A.1, we would prefer that it provides a simpler explanation as to why University A recognises a financial asset (cash) under AASB 1058.8(a), for example, because it becomes party to the contractual provisions of the instrument when the $2 million cash is deposited into its bank account (AASB 9.3.1.1).

Reference for measuring the financial liability on initial recognition

Following on from our comments above regarding the complexity of the discussion around ‘pass-through arrangements’, we do not consider AASB 9.3.2.15 to be the appropriate reference for describing the measurement basis of the financial liability.

> “If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.”
>
> **AASB 9, paragraph 3.2.15**

If the ‘pass-through arrangement’ assessment contained in AASB 9.3.2.5 is not relevant in this fact pattern for the financial asset, it follows that AASB 9.3.2.15 for measurement of the financial liability would not be relevant either. This is because paragraph 3.2.15 only applies to transfers of financial assets that fail the derecognition criteria in paragraph 3.2.5 (e.g. with a securitisation of receivables).

If the Board nevertheless decides to publish revised Examples 3 and 3A.1, we recommend that it amend the reference in the fifth paragraph to be AASB 9.5.1.1 (recognise financial liabilities on initial recognition at fair value) and AASB 13.47 (fair value being not less than the amount repayable on demand, discounted from the first date that the amount could be required to be paid). We also recommend an additional sentence after the fifth paragraph to explain why the financial liability is repayable on demand (e.g. because the alumnus directs when the scholarships are to be paid, which could theoretically all be within one day).

Commentary in the ‘Accounting Treatment’ section regarding AASB 1058.B13

If the Board proceeds with these amendments, we recommend that the first paragraph of the ‘Accounting Treatment’ discussion be deleted (refer extract below). This is because the financial liability on initial recognition equals the $2 million balance of the financial assets (cash) received, so there is no difference to account for under AASB 1058.B13. We believe that including this paragraph in the circumstances is confusing.

> “In accordance with paragraph B13, any difference between the fair value of the asset recognised and the consideration paid for the asset after deducting any other related amounts (being the difference between the $2 million financial asset recognised and a related financial liability recognised) would be accounted as income in accordance with paragraph 10, unless another Standard addresses the accounting for the difference, such as the “day one gain/loss” requirements in AASB 9.”
>
> **Extract of Proposed Example 3A.1 (Accounting Treatment)**

Presentation in profit or loss

The proposed Example 3A.1 is silent on the presentation of this arrangement in profit or loss when scholarship payments are made to recipients. We expect diversity in practice with preparers adopting either of the following approaches in their profit or loss statement:

- No impact – debit financial liability and credit financial asset when scholarship payments made to recipients, or
- Recognise income and equal expense when scholarship payments are made.

In our view, this issue requires further consideration as part of the post-implementation review to provide clarity to affected entities. In particular, users of AASB 1058 need to understand how the ‘principal vs. agent’ assessment is applied in arrangements where the university, research institute or similar body receives funding to be distributed without transferring any goods or services to other parties. This ‘principal vs. agent’ assessment is important because it determines whether the entity recognises grossed up income and expenses, or merely a cash distribution, which in turn could affect whether the entity is ‘large’, ‘medium’ or ‘small’ for the purposes of preparing financial reports for the ACNC.

What if the financial liability is not repayable on demand?

As noted above, we question the usefulness of proposed Example 3A.1 because we consider the fact pattern to be unrealistic. In practice, if proposed Example 3A.1 is adopted by the Board, we anticipate that preparers of not-for-profit financial statements will ask "What if the financial liability is not repayable on demand?".

In this regard, we would recommend the Board add an example dealing with a scenario where:

- The university determines when scholarships are paid out rather than the alumnus
- The financial liability recognised on initial recognition does not equal the $2 million financial asset (i.e. it is recognised at fair value under AASB 9.5.1.1 at the present value of future scholarship payments), and
- The difference on initial recognition between the $2 million cash asset and the present value of the financial liability is recognised applying AASB 1058.B13 and AASB 9.B5.1.2A(b).

If such an example were included, then the first paragraph of the 'Accounting Treatment' discussion for proposed Example 3A.1 (refer extract below) could be included to explain the accounting treatment.

> "In accordance with paragraph B13, any difference between the fair value of the asset recognised and the consideration paid for the asset after deducting any other related amounts (being the difference between the $2 million financial asset recognised and a related financial liability recognised) would be accounted as income in accordance with paragraph 10, unless another Standard addresses the accounting for the difference, such as the "day one gain/loss" requirements in AASB 9."
>
> **Extract of Proposed Example 3A.1 (Accounting Treatment)**

It would also be helpful to include journal entries to explain the accounting for the deferral of the difference over the 10-year scholarship period. That is, assume that the present value of the liability at initial recognition is $1.5 million, the journal entry on initial recognition would be:

Dr Cash	$2 million	
Cr Financial liability		$1.5 million
Cr Unearned income (balance sheet)		$500,000

Interest expense is then recognised over the 10-year period using the effective interest method, with unearned income recognised as interest income at the same amount as interest expense.

BDO Comment - Proposed Example 7A

In drafting proposed Example 7A to AASB 15, we understand the Board's desire to provide guidance for not-for-profit entities receiving up-front fees in a broad range of circumstances. Currently, many not-for-profit entities may ignore the principles in AASB Staff FAQ 12 because they are not schools. However, we question the need for this additional generic example, given the existing guidance contained in AASB 15.B48-B1 regarding non-refundable up-front fees and Illustrative Example 53 to AASB 15.

If the Board decides to proceed with publishing Example 7A, we recommend that AASB Staff FAQ 11 and 12 be withdrawn, or at least noted as merely being one specific example of the application of Example 7A.

Question 2

In respect of not-for-profit private sector lessees, do you agree with the proposal that the current accounting policy choice in AASB 16 paragraphs Aus25.1–Aus25.2 (for not-for-profit entities to elect to initially measure a class of concessionary right-of-use assets at cost or fair value) should be retained on an ongoing basis (i.e. with no plan to reconsider the accounting policy choice)? If not, please provide your reasons.

BDO Comment

Yes, we agree with the proposal to retain the current accounting policy choice in AASB 16 paragraphs Aus 25.1-Aus 25.2 on an ongoing basis.

Question 3

Do you agree that the disclosures required by AASB 16 (including the requirements in AASB 16 paragraphs Aus59.1–Aus59.2) provide sufficient information to users of financial statements in the absence of fair value information? Are there any other disclosures regarding concessionary leases that would be useful to users of financial statements without incurring undue cost or effort for preparers? Please provide reasons to support your answer.

BDO Comment

Yes, we agree. We do not think any additional disclosures are necessary.

Question 4

If in response to Question 2 you consider that not-for-profit private sector lessees should be required to initially measure right-of-use assets arising under concessionary leases at fair value, do you consider that the initial fair value measurement requirement should be applied:

a) prospectively, to concessionary leases entered into after the date of application of the removal of the accounting policy choice to measure such right-of-use assets at cost; or
b) retrospectively (i.e. requiring existing right-of-use assets arising under concessionary leases to be adjusted to reflect the effect of the initial fair value requirement)? Please provide reasons to support your view.

BDO Comment

N/A.

Question 5

In respect of not-for-profit public sector lessees, do you agree that, in the absence of fair value information about concessionary leases, the disclosures required by AASB 16 (including the requirements in AASB 16 paragraphs Aus59.1–Aus59.2) provide sufficient information to users of public sector entities' financial statements? Are there any other disclosures regarding concessionary leases that would be useful to users of public sector entities' financial statements without incurring undue cost or effort for preparers? Please provide your reasons to support your answer

BDO Comment

Yes, we agree. We do not think any additional disclosures are necessary.