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The Chair
Australian Accounting Standards Board
PO Box 204
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via email: standard@aasb.gov.au

Dear Keith

AASB Exposure Draft ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases*

Deloitte is pleased to respond to Australian Accounting Standards Board ('AASB' or 'Board') Exposure Draft ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases* (ED 318). We appreciate the opportunity to comment on this Exposure Draft to ensure the proposals, as a whole address the specific concerns raised by stakeholders and issues we have observed in practice.

Overall, we support the Board's proposals to provide much-needed clarity for stakeholders via the following proposed amendments to:

(a) Add Illustrative Example 7A in AASB 15 *Revenue from Contracts with Customers* (AASB 15) to clarify accounting for upfront fees;

(b) Amend Illustrative Example 3 in AASB 1058 *Income of Not-for-Profit Entities* (AASB 1058) to clarify the analysis regarding the recognition of a financial liability; and

(c) Retain the accounting policy choice in AASB 16 *Leases* (AASB 16) paragraphs Aus25.1–Aus25.2 on an ongoing basis for not-for-profit private sector lessees to elect to initially measure a class of concessionary right-of-use assets at cost or fair value.

We do have comments on certain aspects of the proposals specifically around the amendments to Illustrative Example 3 in AASB 1058:

- Whilst we agree with the proposals to amend Illustrative Example 3 and 3A.1 in AASB 1058 to clarify the analysis regarding the initial recognition of a financial liability, we believe that the amended example does

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not adequately address the key concern that many not-for-profit (NFP) entities have, being the subsequent accounting for the financial liability and related income. In order for the proposed amended example to address the subsequent accounting requirements, we note that it would need to be expanded to include a detailed analysis on principal versus agent accounting considerations.

- The difference between principal vs. agent accounting will also have flow-on consequences on the reporting requirements for charities reporting under the Australian Charities and Not-for-profits Commission (ACNC). Due to the difference in revenue accounting under principal vs. agent (gross-up vs. net), this may result in charities reporting under ACNC moving between tiers as the ACNC reporting tiers are assessed based on annual revenue.
- Whilst we agree with the inclusion of Example 3A.2, we believe the example would be more helpful if it includes more complexities to draw out judgemental implementation issues.

Our detailed responses to the specific matters for comment in the exposure draft are outlined in the Appendix.

Please contact me at +61 3 9671 7871 or moverton@deloitte.com.au if you wish to discuss any of our comments.

Yours sincerely

MOverton

Moana Overton
Partner

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APPENDIX – DETAILED RESPONSES TO THE AASB REQUEST FOR COMMENTS IN ED 318

Proposed amendments to AASB 15 and AASB 1058 (all not-for-profit entities)

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**

Example 3 and Example 3A.1 – Financial instrument (cash scholarships, not goods or services, financial liability under AASB 9)

Whilst we agree with AASB's intention to amend Illustrative Examples 3 and 3A.1 in AASB 1058 to clarify the analysis regarding the initial recognition of a financial liability, we believe that the amended example does not adequately address the key concern that many NFP entities have, being the subsequent accounting for the financial liability and related income.

In order for the example to address the subsequent accounting requirements, our view is that the example should focus on whether the NFP entity is the principal or an agent as this is a common implementation issue. We note that the current proposed example includes a discussion around pass-through and derecognition analysis which could be interpreted to imply that the NFP entity is the principal in the scenario. We believe that the above interpretation may not be appropriate as we think the NFP entity described in the example demonstrates some indicators of being an agent, given it has no discretion on how the funds are disbursed. Under agency accounting, the initial and subsequent accounting of this transaction would have no gross-up impact on the profit and loss line items in the financial statements of the entity, meaning it will result in the following subsequent accounting journals upon derecognition of the asset and liability. The example currently does not provide a clear analysis of the principal versus agent accounting for the NFP entity. This could be misleading as NFP entities may analogise to this example to apply principal accounting to gross up their revenue and expenses in the subsequent accounting for the financial liability. Such treatment may or may not be appropriate, which could be determined only after appropriate consideration of whether the NFP should be considered an agent or a principal in the specific arrangement. Accordingly, we recommend that the example should be improved by linking the current derecognition and pass-through analysis to the principal versus agent assessment, in order to appropriately address the subsequent accounting for the financial liability and related income (gross versus net revenue).

We note that the example requires the initial recognition of a financial asset and an equal amount as a financial liability but does not clarify the reasons behind this measurement. We believe the example can be improved by clarifying that the value of the financial liability equates to the value of the financial asset (cash) received. This is because the grantor has the ability to instruct for all amounts to be repaid immediately and therefore it is akin to an on-demand liability. Consequently, the fair value of the liability is its face value being the amount payable on demand, discounted from the first date that the amount could be required to be paid in accordance with AASB 13.47.

It is also important to note that the difference between principal vs. agent accounting will have flow-on consequences on the reporting requirements for charities reporting under the ACNC. NFP entities that apply principal accounting will report gross-up revenue and expenses while NFP entities that apply agency accounting will report it net (no recognition of revenue on disbursement of funds) – this may result in charities reporting under ACNC to move between tiers as the ACNC reporting tiers are assessed based on annual revenue. While we understand the AASB is not intending for any changes in current practice arising from these amendments, these unintended consequences may occur as entities analogise to the amended example to determine its role as principal versus agent, and correspondingly materially change their reported revenue on which ACNC reporting requirements are based.

Example 3A.2 – Income (not goods or services, income under AASB 1058)

We agree with the inclusion of Example 3A.2 as we believe additional examples are beneficial in providing guidance to NFP entities applying AASB 1058. However, we believe the current example would be more helpful if it includes more complexities to draw out judgemental implementation issues. Complexities could include additional terms around interest income, charging of a certain administrative fee (we understand many funds disbursement entities charge a certain fee to the grantor for its services) or the illustration of a common school scenarios between college entity and the foundation (e.g., the grantor donates funds to the foundation which in turn passes it on to the college entity). Consistent with our comments noted above for Examples 3 and 3A.1, we believe Example 3A.2 should also focus on addressing the issues around principal versus agent and subsequent accounting requirements.

Example 7A – Accounting for upfront fees

We agree with the inclusion of Example 7A as we believe additional examples are beneficial in providing guidance to NFP entities applying AASB 15. We note the principles illustrated in Example 7A are consistent with the upfront fees accounting requirements of AASB 15 which have also been incorporated in the AASB 1058 AASB Staff FAQs and therefore we have no further comments on this from a technical perspective.

Concessionary leases (not-for-profit private sector lessees)

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.**

We fully support the proposal to retain the current accounting policy choice in AASB 16 paragraphs Aus25.1-Aus25.2 for not-for-profit private sector lessees on an ongoing basis.

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.

We 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. We have no further suggestions on additional disclosures which may be useful to users of financial statements without incurring undue cost or effort for preparers.

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 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.

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As noted in Question 2 above, we support the retention of the current accounting policy choice in AASB 16 Aus25.1-Aus 25.2. However, in the event that the AASB decides that fair value should be applied by NFP entities when measuring right-of-use assets arising under concessionary leases, our view is that the initial fair value measurement requirement should be applied prospectively. This is because, in our opinion, the cost of applying the initial fair value measurement of right-of -use assets under concessionary leases retrospectively will significantly exceed the benefits of related disclosures to users of the financial statements.

Concessionary leases (not-for-profit public sector lessees)

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.**

In respect of not-for-profit public sector lessees, we 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. We have no further suggestions on 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.

General matters for comment

6. **Whether the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft?**

Based on our observations we believe the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft.

7. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?**

As noted in our response to Question 1 above, we are concerned that entities may read into proposed example 3A.1 a conclusion as to whether they should be considered a principal or an agent in various transactions that may or may not be appropriate depending on their specific circumstances. We are concerned that this may have an unintended regulatory impact, as the tiering in the ACNC reporting requirements is based on annual reported revenue, which may materially change for some NFP entities as a result of the principal vs. agent determination.

Other than as noted above, we are currently not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

8. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?**

We echo the same view expressed in Question 7 above and make no further comments.

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9. Whether, overall, the proposals would result in financial statements that would be useful to users?

We echo the same views expressed in Questions 1 & 2 on the proposed amendments to AASB 15 and AASB 1058 illustrative examples and proposed decisions to retain the accounting policy choice in AASB 16 concessionary leases of not-for-profit private sector lessees. We are supportive of the AASB providing additional guidance (via illustrative examples) for NFP entities in the application of AASB 15 and AASB 1058 but as noted in our responses to Question 1 above, we believe improvements should be made to the examples to make them more useful to the stakeholders.

10. Whether the proposals are in the best interests of the Australian economy?

We believe the current proposals outlined above is in the best interests of the Australian economy.

11. Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?

We have no further observations on this in addition to those already outlined elsewhere in this letter.