

08 November 2019

Australian Accounting Standards Board
Podium Level 14,
530 Collins Street,
Melbourne VIC 3000

Dear Board Members

AASB 2019-X AMENDMENTS TO AUSTRALIAN ILLUSTRATIVE EXAMPLES FOR NOT-FOR-PROFIT ENTITIES & STAFF FAQ UPDATES ACCOMPANYING AASB 15

In light of recent discussions with our direct auditor, we have recognised a few key differences caused by interpretations of the recent draft documents released by the AASB, particularly with regard to the treatment of Commonwealth supported competitive research grants (eg: ARC/NHMRC). It has been highlighted to us that our auditor is yet to release an official view of their position and so any matters mentioned below are not reflective of a confirmed view (from our auditor) and should only be read as our current understanding through ongoing discussions.

The proposed changes are currently being used as a deciding factor to treat all Commonwealth supported competitive grants with a point in time revenue recognition that is not pragmatic for the Universities and the auditors themselves to record and audit respectively.

Notwithstanding the above implications:

- i. We do not agree with the proposed amendments to Example 4A of AASB 15 and the AASB Staff FAQ 5 (chart 3);
- ii. The AASB **should not proceed** with its amendments to Example 4A of AASB 15 on the basis that the proposed changes lead to a contradictory interpretation of the board's basis of conclusions and AASB 15 B4 - B5; and
- iii. We highlight that the original FAQ 5 created with the involvement of BDO is in line with the original intention of the board on how AASB 15.35(a) must be addressed. (<https://www.bdo.com.au/en-au/accounting-news/accounting-news-june-2019/grants-to-nfps>)

1. Interpretation of “contemporaneous” receipt and consumption of benefits

There is an inconsistent and unclear interpretation of the word “contemporaneous” between the sector and auditors. Our conversations with our auditor have led us to believe that they consider ARC/NHMRC projects to be a single performance obligation that does not meet AASB 35(a) for over time recognition for ARC/NHMRC projects on the grounds that the *customer does not have immediate access to the research findings and data as the work is performed*. We believe that the board intended for a broader interpretation of the word “contemporaneous” to mean either

- i. At least annually;
- ii. Within the lifespan of the project; or
- iii. "Simultaneous" in the context of the research (disregarding practical limitations as per BC 127)

We form the above-mentioned definition of “contemporaneous” **based on the comments made by the AASB at the most recent teleconference in which it was acknowledged that a transfer of a benefit “at least annually” can be deemed as contemporaneous receipt and consumption of benefit**. We believe that the comments made is in line with BC 127 which states that the *entity must disregard any contractual or practical limitations* in assessing the simultaneous receipt and consumption criterion.

This would mean that BC 128 restrictions do not apply (as ARC/NHMRC projects would have a contemporaneous receipt and consumption of benefits) and, in line with B3 - B4, the single research performance obligation would meet the requirements of AASB 35(a) as per the reasoning in BC 125, BC 126 and BC 127.

The inconsistent and fluctuating use of the words “simultaneous” and “immediate” in the standard, coupled with the use of the word “contemporaneous” in the Example 4 is not helpful, especially in the application of BC 125 to BC 128. We believe the original intention of the board was to navigate through all of the paragraphs together, as opposed to referring independent paragraphs, which can lead to mis-interpretations (in the event of a varied interpretation of “contemporaneous” and “simultaneous”).

On a separate note, there is also an ongoing discussion with our auditor about the specific “benefit” created from the performance obligation with regards to Commonwealth funded competitive research being broader than the research findings alone (as per the customer’s intentions). This is further discussed in point 3 below, and would lead to dispute the assumptions currently made regarding the benefit created from public funded research. It will expand on what exactly the “contemporaneous benefits” received and consumed by the customer (and third parties) are in the context of research, as per the customer’s objective for providing the funding to the entity and clarify what the customer considers as a specific performance obligation.

2. Use of “AASB 2019-X Fatal Flaw” and FAQ 5 as the basis for AASB 35(a) requirements

The fatal flaw document may lead to an inconsistent interpretation of the requirements to meet AASB 35 (a). The original intent of the Board (in line with BC 126 and 127) is reflected in the **original** wording of example 4A, with the focus being on **both** the contemporaneous receipt and consumption of the benefit **and** the test of whether work needs to be re-performed as the key determinant of whether benefits are being simultaneously consumed.

BC3 of AASB 2019-X states that “*if it is uncertain whether the customer (donor) **simultaneously receives and consumes the research service**, it is necessary to refer to paragraph B4 to determine whether paragraph 35(a) is satisfied*”. The AASB’s proposed deletion of the phrase “*another entity would not need to substantially re-perform the research completed to date by the institute if that other entity were to fulfil the remaining performance obligation to the donor (paragraph B4)*” in Example 4A is justified *if* the application of paragraph 35(a) to the fact set in the example is ‘clear’.

However, we believe that **the original fact set of Example 4A was stated as it did to show an “unclear” scenario, which is more realistic for the industry**. Altering the fact set contained in Example 4A to focus on the research output (and not the research service) is contradictory to AASB F20 and F22 requirements for what is deemed a performance obligation. Furthermore, we believe the proposed alterations and deletions were made to support a conclusion where the simultaneous receipt and consumption is clear, but this is not reflective of a standard research process. Providing illustrative examples that merely restate this principle is not, in practice, helpful.

Furthermore, the AASB’s proposed amendment means that the illustrative examples would **no longer illustrate a scenario where paragraph B4 would be applied**. It would be more useful for the AASB to leave Example 4A as originally written (as per the Board’s original intention), or include a scenario similar to that described in BC126 –BC127 of AASB 15 where paragraph B4 of the Standard would be applied to a research contract, bearing in mind that “simultaneous” in the context of research does not mean “immediate” but may plausibly be considered as “contemporaneous”.

The amendments illustrate a scenario that is unrealistic or does not occur in practice. Consequently, the amendments are of no practical use. We fear that the illustrative examples have been developed by creating hypothetical fact sets that results in each of the outcomes in paragraph 35(a) – (c). However, the amendments to Example 4A result in a scenario that is unrealistic and does not occur in practice. Based on our experience, most research agreements do not contain a specific condition that the entity ‘contemporaneously publish’ its findings as they are obtained, as this is not indicative of standard research methodology. We understand that the scenarios described in Example 4A and the AASB Staff FAQ, if they ever occurred, would result in the conclusions described in those examples. However, we fear that other entities may approach the logic in reverse, especially if they are not aware of the variability that exists in public funded research. That is, paragraph 35(a) of AASB 15 can only be applied where the entity’s actual fact set is identical to fact set described in the illustrative example.

We would like to highlight that as per AASB 15 B4 - for types of performance obligations where one cannot readily identify whether a customer simultaneously receives and consumes the benefits from the entity’s performance as the entity performs (due to the mis-match in interpretations of “contemporaneous” receipt and consumption), a performance obligation satisfied over time exists;

- i) *if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer (AASB 15 B4); and*
- ii) *the entity must **disregard any contractual or practical limitations** in assessing the above (AASB 15 – BC 127)*

If contractual and practical limitations are disregarded, the very proof of simultaneous consumption of benefit by the customer lies in the fact that a replacement service provider need not do any of the research activities already performed all over again. If a termination happens at any stage and the provisions in the agreement provide for the customer instructing the unrecognisable knowledge asset at that stage to be passed on to the new entity (by requiring all the confidential information and work till date to be transferred to the new institution as per Clause 4.19(d) in the NHMRC agreement), it would also indicate that the customer has control throughout the project term (AASB 15.35(b)) in addition to having unlimited access to the project related information through other means over the course of the project. This is also given the fact that NHMRC/ARC can terminate these projects without any assigning reasons and while doing so ensure there is no loss on termination (Clause 14.1).

3. Assumptions made on the “benefit” received and consumed

We would like to also highlight that there is the high possibility of misinterpreting the specific performance obligation created by the contract with a customer if the “benefit(s)” to be transferred are not clearly understood, and thus lead to an incorrect accounting treatment. If the focus is merely on one commercial/economic benefit, then the accounting treatment would be determined based on that benefit alone. We believe that our auditor’s current focus with regards to the customer’s expected “benefit” revolves around their “translative” strategy only, and its “investment” strategy (focusing on building research capability, infrastructure and innovative action) is not sufficiently addressed.

The NHMRC/ARC corporate plans (refer to appendix) explain how the benefit to the grantor (and third parties) is much broader than merely the research output. The customer further highlights this through funding rules and grant application guidelines that clearly state that the researcher will be measured on multiple fronts. Specificity can be derived from the application process that seeks to address these measures, combined with industry knowledge of the implication of a researcher’s past history, knowledge of the peer reviewer about the research process, and the scoring provided to applications. The research output is only one benefit that is considered. Notwithstanding the above, **the outputs do not have to be specified in terms of timing and quantity, and that nature or timing or value alone combined with specificity in the research activities is sufficient (as per AASB 15 F20 & F22)**. The grant itself is awarded on a competitive basis, where **research output is only one benefit that is considered**.

Based on the NHMRC’s [strategic objectives](#), there are a broader range of benefits than just knowledge to be shared, such as:

- a. Creating knowledge
- b. Building research capability and infrastructure
- c. Translating health and medical research into
 - i. Improvements in clinical practice
 - ii. Improvements in policy
 - iii. Improvements in health systems
 - iv. Effective commercialisation of research discoveries.

The above benefits (embodied in the ARC corporate plan as well) are the outcomes of research activity, and it is our view that the research activity itself, together with those benefits, are a single performance obligation, which is satisfied as the research service is performed (as opposed to only when the research output is published).

4. Further mis-matches in interpretations within the sector

Notwithstanding the above, should the Board continue with the amendments without any further clarifications on the above-mentioned matters around satisfaction of AASB 15 para 35 (A), and deem that “research activities do not lead to a contemporaneous consumption of benefits” **and there is no uncertainty whatsoever (as per our auditor’s current interpretation)**, then the following matters need to be addressed;

- a. Satisfaction of AASB 15 para 35(B) - The question of “*Does the entity’s performance create or enhance an asset that the customer controls as the asset is created or enhanced?*” - Clarity required on “control”.

Our auditor refutes AASB 15 para 35 (B), on the grounds that *no one has access to, or control over the research and findings until they are shared by the university*. We believe that clause 11,14 & 15 of the NHMRC funding agreement passes a degree of “control” of the unrecognised knowledge asset to the funding body, **by granting the customer access and rights to inspect all information and performance of the research activity**. We have been informed that our auditor has determined this clause to be irrelevant based on a correspondence they have received which states that the clause cannot be used by the grantor to benefit from the research findings. We believe that the actual question is based on “control” only, and not whether the grantor will definitively use the research findings (which is merely one of many benefits created from this performance obligation) for an economic benefit.

AASB 15 - 33 defines “control” as **the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset**. In other words, what matters is whether they **can** access the information (akin to access rights), not whether they will definitively use it for an economic benefit. This was a matter that was also commented on by the AASB in the recent teleconference, with how the focus is on the customer being able to access, and not whether they actually do. If the focus is merely on control, and benefit sought by the customer (or third parties) is as per the intention of the NHMRC mentioned in point 3 above, then there is sufficient evidence to state that while they may not intend to use/benefit from the research output, the NHMRC does in fact have control over the research service performance obligation, which they can direct the use of (through access in clause 11 and actions listed in clause 14 & 15) and will therefore lead to obtaining all remaining benefits to themselves and third parties (in line with the benefits sought in point 3) from the unrecognisable knowledge asset.

- b. Satisfaction of AASB 15 para 35 (C) - Should the determination be that the NHMRC does not clearly have control over the unrecognisable knowledge asset, the AASB would need to provide guidance on the path to follow should it be uncertain at contract inception if the research activities (or the unrecognisable knowledge) would have an “alternative use”:
- i. AASB 35c) & 36) mentions that there is no alternative use if entity is **limited practically** from **readily directing the asset in its completed state for another use at contract inception** – the alternative use for any research findings, in line with AASB 15 B6, will have practical limitations in its completed state to readily direct that asset for another use (ie: the University may have to file and pay for patents to attract further funding, incur expenses to engage potential industry partners for further funding and adhere to their requirements, or develop educational teaching material out of the research findings for use in teaching) – therefore, as per the requirements of the standard, it is uncertain if alternative use exists for the research findings in its **“completed state”** at the point of meeting the NHMRC performance obligation.

As per AASB 15 B8, all of the above can also be considered as costs to re-work the research findings before it leads to an alternative use for the University. It is interesting to note that the definition of the word “re-work” *is make changes to the original version of something*, but our auditor appears to be defining it as *re-performing substantially the research activity that leads to a specific research finding*. This view of “re-working” is further hindered by the narrow view of the “benefit” referred to in point 3 above.

- ii. Separate to point above, attempts at commercialisation of the knowledge results in significant economic loss to the university, so even in a stricter interpretation we believe there is still a practical limitation to alternative use of the research findings **in its current “completed state”**. Universities have entire divisions with business development managers employed to attract investors, invest internal funds in projects, educate students on setting up start-ups (as further funding is not always guaranteed) – all of which comes at significant economic loss when compared to the original funding granted by the NHMRC for the research activities.

c. **Conclusion**

- 5.1 We believe that the original Example 4A is not incorrect (and **is consistent** with the requirements of F20 and F22) and the AASB need not proceed with the AASB 2019-X amendment to Australian Illustrative Examples for Not-for-Profit Entities accompanying AASB 15.
- 5.2 We believe that the alteration of chart 3 in FAQ 5 to segregate BC 125 to BC 128 in assessing AASB 15 35(a) is not consistent with B3 and B4, and in its current altered state is leading to inconsistent and ineffective discussions with auditors, especially on Commonwealth funded competitive research. We believe the original version of this flowchart more accurately depicts a broader spectrum of research.
- 5.3 We highlight that the changes to Example 4A will lead to further mis-interpretations of the standard which contradict the original intentions of the Board, especially by entities who do not fully understand the sector, its customers or the benefits received and consumed by the customer (and third parties).
- 5.4 We believe that the amendments to Example 4A would leave the sector **without** an illustrative example that portrays how B4 should be applied, noting that the original version of the example provided more clarity in this regard.
- 5.5 If the AASB intends to amend Example 4A, we would encourage the AASB to ensure the above matters are addressed appropriately. In such a case, it should make those further amendments available for public comment.

Several Universities in the sector have expressed similar concerns with regards to the potential risk of mis-interpretation caused by these proposed changes. We hope you are able to take our comments into consideration when making a decision on this matter, while bearing in mind that your decision has potential impacts that could alter the course of public funded research and innovation in Australia.

6. Appendix – The “benefit” received and consumed by the customer (and third parties)

Figure 1: The ARC’s role

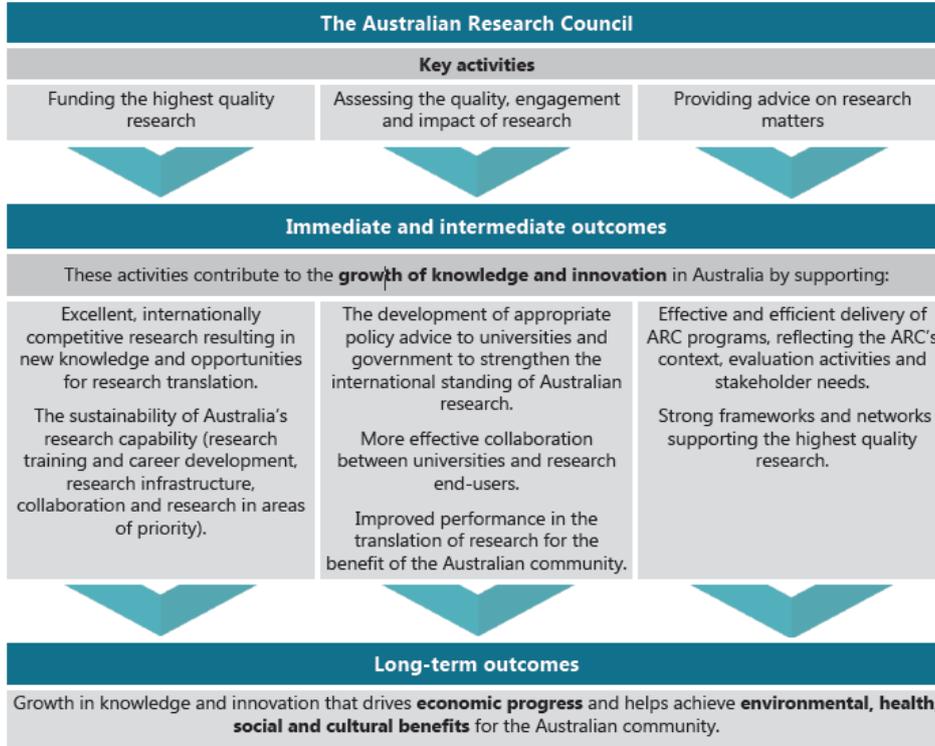


Figure 1: ARC Corporate Plan – The “benefits” received and consumed
<https://www.arc.gov.au/policies-strategies/policy/corporate-plan>

Figure 1: NHMRC’s strategy for health and medical research

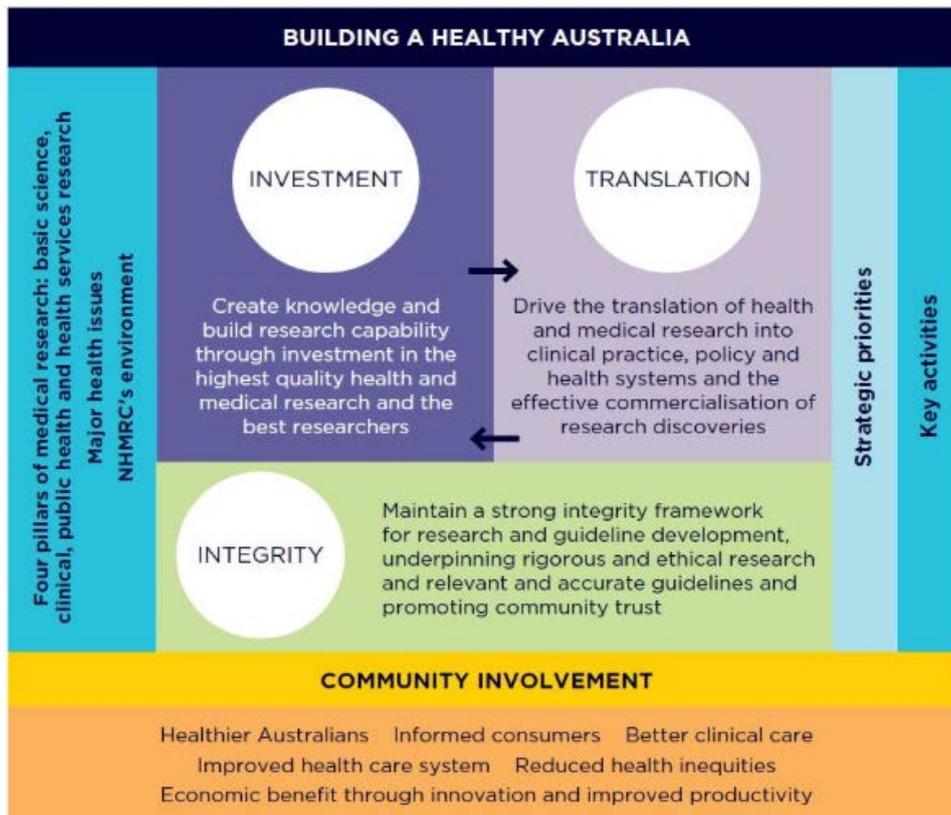


Figure 2: NHMRC Corporate Plan – The “benefits” received and consumed
<https://nhmrc.govcms.gov.au/about-us/publications/nhmrc-corporate-plan-2019-20>