

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
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By email: standard@asb.gov.au

13/08/2015

Dear Ms Peach

The Australian University Senior Finance Officers Group (“AUSFOG”) is pleased to provide input to the consultation process being undertaken by AASB relative to ED 260.

AUSFOG is a collaborative association of senior finance officers representing 37 Universities across all states and territories. The Group formally meets twice annually and corresponds regularly throughout the year on matters that impact on the financial operations of the Sector. The Group also liaises closely with the State Audit Offices on matters such as compliance with Accounting Standards and Department of Education and Training reporting requirements.

AUSFOG believes that the existing accounting treatments for revenue recognition under current Standards are unsuitable for entities such as Universities and have been so for many years. It is AUSFOG’s hope that pragmatic, clear and common sense new standards will be the outcome of this consultation.

Our submission is in two parts. The first section sets out our responses to the matters on which AASB is seeking specific comments and the second section discusses some points around practical implementation and views on the cost/benefit implications that may arise as a consequence.

We would be pleased to provide further information, either in writing or in person, to the AASB and its staff and thank you for the comprehensive consultation process that you are undertaking.

Yours sincerely

Stuart Donaldson
AUSFOG Chair 2015
Chief Financial Officer
RMIT University

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AUSFOG works together to:

- Explore and share knowledge of best practice across Finance activities,
- Consider innovative approaches to enhance the value to universities that Finance functions could deliver,
- Champion/influence matters of financial import to peak bodies such as Department of Education and Training, Department of Industry and Science, Universities Australia, Audit Offices (NSW, ACT and Commonwealth) and State, Territory and Federal higher education ministers,
- Identify and action benchmarking of specific finance activities,
- Engage ‘outside’ assistance (e.g. Large Accounting firms) as required to provide advice or represent the Group on the financial implications of changes to accounting standards and taxation legislation.
- Discuss and clarify the year-end audit process and raise any concerns with representatives of the Audit office(s). This will include proposed changes in Accounting Standards and Department of Education and Training reporting requirements.

An underlying principle of the Group is to foster professional and open relationships by the informal sharing of knowledge and experience.

Our submission is in two parts. The first section sets out our responses to the matters on which AASB is seeking specific comments and the second section discusses some points around practical implementation and views on the cost/benefit implications that may arise as a consequence.

Specific Matters for Comment

Question 1

In relation to the AASB proposal to replace the reciprocal / non-reciprocal transfer distinction in AASB 1004 with income recognition requirements based on whether a not-for-profit entity needs to satisfy a performance obligation:

- (a) do you agree that this proposal would provide a faithful depiction of a not-for-profit entity financial performance?
- (b) if not, what alternative approach to income recognition would you recommend for not-for-profit entities? Please provide your reasons.

Response

ED 260 replaces the reciprocal/non-reciprocal test with a number of tests.

The ‘sufficiently specific performance obligation’ test in AASB 15 requires that there is a transfer of a good or a service to a customer. In many cases, this would not apply to grants or donations made to universities and as such, many government grants, and philanthropic donations would not be captured by AASB 15 but would be caught instead under AASB 10XX.

In AASB 10XX, the test is that when recognizing an asset, any other liability that arises out of the contract should also be recognized. This may cause a deferred income liability to be recognized similarly to that which would have been recognized under AASB 15, but for different reasons.

Our view is that this is an overly complex approach that arises out of using a 'for-profit' standard to evaluate transactions that regularly occur within the university sector and which are not well suited to a for-profit commercial approach. As a result, the required analysis is likely to impose a significant cost and administrative impost on a university and one that generates no return or value. It is also probable that the level of judgment and interpretation required to analyse a contract for a grant or a donation would lead to differential and inconsistent evaluations of similar circumstances across 38 universities.

Similarly, it is probable that some donations would be captured under AASB 15 (for instance, a donation for a scholarship where there is a transfer of a good or service to a customer) while a donation to support research (where there is no transfer of a good or service to a customer) would be captured under AASB 10XX. Perhaps the same accounting result would be achieved (depending on the nature of any liabilities arising from the contracts) but the reasons for the accounting treatment would be different.

It is our view that the replacement tests in AASB 15 and AASB 10XX are therefore more complex, more costly and difficult to administer and produce no value to the university.

Question 2

In relation to the AASB proposal that, to qualify as a performance obligation, a not-for-profit entity promise to transfer a good or service to counterparty in a contract must be sufficiently specific to be able to determine when the obligation is satisfied (see paragraph IG13 of Part A):

- (a) Do you agree with this proposal?
- (b) If not, what factors or criteria should apply to determine whether a not-for-profit entity has a performance obligation? Please provide your reasons.

Response

Yes, we agree with the principle. However, for Universities, contracts for the performance of research funded by the Commonwealth or its agencies have distinctive characteristics that the test of "a promise to transfer" would not cover. This is the area in which Universities have encountered the most contention and difficulty in having to comply with AASB 1004.

The most prolific example of this is the undertaking of research projects funded by a government grant, such as from National Health and Medical Research Council and Australian Research Council, which usually have a three-year duration. The outputs of the research can be either tangible or intangible and, almost always, no goods or services are actually transferred to the granting body.

The AASB should be aware that the scale of research activity at Australian Universities is immense, with each entity having many thousands of individual research projects underway at any one time. Some Universities have research revenue in the many hundreds of millions in any given year.

As such, there is very significant risk of unnecessary complexity and major overhead in managing revenue recognition if it were to be based on individual contract performance assessments of research grant agreements.

All grant agreements have expectations of deliverables. It is acknowledged that these deliverables are not always directly returned back to the grantor and may in fact go to third parties.

The University retains the intellectual property discovered by the project. The contractual deliverable is the actual conduct of the research itself, reporting on its progress towards milestones and outcomes set by the grantor and then publication of results in scholarly journals or through conference presentations.

Therefore the performance criteria indicated in the ED, “transferring a promised good or service to the customer (which occurs when the customer obtains control of that good or service”, might never take place. However, there are always very specific and detailed performance obligations expressed in the contract from the grantor, including an obligation to return unspent funds. Being able to measure the attainment of these performance obligations is not an issue.

Our preferred alternative approach would be to allow a University, if it chooses, to recognise revenue based on the relationship to the costs proportionally incurred within the reporting period, as in the traditional “matching concept”. This approach would then allow Universities to have the option of addressing the revenue recognition challenge for external reporting purposes of research grants at a global level of revenues and expenditures across the University rather than down at an individual contract level.

Given that the NFP sector generally and universities in particular have very different operational practices than those in the for-profit sector, it is our view that the use of AASB 15 in respect to the transfer of goods or services is not appropriate.

For the reasons set out above, the NFP guidance to AASB 15 should be amended to allow consideration of transactions with performance obligations that do not include a transfer of goods or services and to allow consideration of contracts that do not give rise to any form of liability. This may obviate the need for AASB 10XX to be issued.

Therefore we believe it is appropriate that research grant revenue be recognised as and when each performance milestone described in the grant contract is met, or proportionally by the effluxion of time over the life of the grant, whichever is most appropriate in each instance.

Although there is no good or service delivered and transferred, we believe that the income be recognised as that arising under a contract. We do not believe that it should be treated as either as “other income, a liability (e.g. a refund liability) or a contribution by owners”. The Commonwealth Government is not usually regarded as “the owner” of a University.

There are also a number of regular grants from government that fund specially designed programs in such areas as teaching performance, access and equity. These are acquitted to the granting body, based on the expenditure incurred to deliver the particular program. We recommend that the revenue be recognised in line with the expenditure and that unspent cash at balance date be recorded as deferred income.

Further, there are competitive grants provided by Australian Research Council for the acquisition of capital equipment to be used by more than one institution.¹ The grant is made to a lead institution that records the revenue as received, capitalizes the asset and depreciates it over its effective economic life. In this situation, no good or service is delivered but there are clear performance obligations under the grant. We recommend that such grants be recognised over the life of the asset to offset the corresponding depreciation expense. We further recommend that all capital grants be recognised as revenue over the effective life of the asset being funded.

¹ Australian Research Council, *Linkage Infrastructure, Equipment and Facilities* scheme, <http://www.arc.gov.au/linkage-infrastructure-equipment-and-facilities> - accessed 22 July 2015

Question 3

Do you agree with the proposal in paragraphs IG19-IG30 of Part A that a not-for-profit entity would recognise a donation component in a contract with a customer as immediate income only if:

- (a) A qualitative assessment of available evidence indicates that the customer intended to make a donation to the not-for-profit entity; and
- (b) The donation component is separately identifiable from the goods or services promised in the contract? (See also paragraphs BC36-BC49 of the Basis for Conclusions.)

If not, under what circumstances should a not-for-profit entity identify and account separately for a donation that is provided as part of a contract with a customer?

Response

Yes, we agree with the principle but believe there would seldom be such instances in Universities

Question 4

In relation to the AASB proposals to:

- (a) Permit any not-for-profit entity to recognise volunteer services as income if the fair value of those services can be measured reliably; and
- (b) Carry forward the requirement in paragraph 44 of AASB 1004 that particular public sector entities must recognise volunteer services if those services would also have been purchased if they had not been donated,

The AASB seeks views on:

- (a) Whether the requirements (if any) for the recognition of volunteer services should be the same for all not-for-profit entities, regardless of whether they operate in the public or private sector; and
- (b) If your answer to (a) is yes, whether the recognition of volunteer services should be:
 - (i) Optional, provided that the fair value of those services can be measured reliably; or
 - (ii) Required if those services would also have been purchased if they had not been donated.

(See also paragraphs BC59-BC63 of the Basis for Conclusions.)

Response

Yes, we agree with the principle that there be common basis irrespective of public or private sector.

It is common practice in Universities that Adjunct staff and Emeritus Professors are regularly involved in presenting guest lectures in courses, supervising field excursions such as archeological digs, taking part in the examination of Doctoral theses or participating as panel members in quality reviews. Their participation may be just for a few hours or accumulate to a few days annually. These services are usually given to enable their knowledge and interest in education to be utilised to enhance the student experience or efficacy of reviews. They are not substitutes for paid services.

We note that we would not be required to perform an exhaustive search for volunteer services and would regard any compulsion to record and value such services as unduly onerous administratively and the staff time to perform such analysis incredibly expensive, as well as being immaterial in the context of total revenues of a University.

We would not be at all in favour of any change that required mandatory recognition of any value of volunteer services.

In our opinion, the “volunteer services” needs a definition in the proposed standard. Do they include other “in-kind” equipment, space etc? Definition will clarify if other in-kind services are in the scope and will follow the same treatment as the volunteer services.

Question 5

Do you agree with the proposal in paragraph 38 of [draft] AASB 10XX that, when inventories are donated to a not-for-profit entity other than as part of a contract with a customer, assessments of whether the donations are material should be made on an individual transaction basis without reassessment at a portfolio or other aggregate level?

(See also paragraphs BC50-BC51 of the Basis for Conclusions.)

Response

Such donations should be captured and assessed at point of entry into the organisation. A reassessment can occur at the end of the reporting period for that class of inventory.

Question 6

Australian Accounting Standards applicable to for-profit entities do not include a definition of contributions by owners. Further, concerns have been expressed by some that the definition of contributions by owners in AASB 1004 is too narrow. Do you consider that a definition of contributions by owners is still necessary, or appropriate, in Australian Accounting Standards? If so, would you prefer using:

- (a) The definition of contributions by owners presently in AASB 1004; or
- (b) The definition of ownership contributions in the Public Sector Conceptual Framework issued by the International Public Sector Accounting Standards Board (IPSASB)?

(See also paragraphs BC84-BC91 of the Basis for Conclusions.)

Response

We have no view on this question as it seems unlikely there would be such instances in Universities.

Question 7

The AASB also seeks views on the following issues related to contributions by owners:

- (a) Whether, in view of concerns expressed by some that using AASB 1004 definition of contributions by owners in AASB Interpretation 1038 Contributions by Owners Made to Wholly-Owned Public Sector Entities (which includes for-profit public sector entities in its scope) might prevent a for-profit entity in the public sector from making an unreserved statement of compliance with IFRSs, AASB Interpretation 1038 should be:
 - (i) Withdrawn;
 - (ii) Retained but with narrower application [that is, limited to not-for-profit entities in the public sector, and possibly also confined to identifying which not-for-profit public sector entities should account for transfers between them when they are controlled by the same parent (government)]; or
 - (iii) Retained without amendment?

(See also paragraphs BC84-BC94 of the Basis for Conclusions.)

(b) Whether requirements for restructures of administrative arrangements (presently set out as paragraphs 54-59 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraph BC90(b) of the Basis for Conclusions);

(c) Whether requirements for distributions to owners (presently set out as paragraphs 49 and 53 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraphs BC94-BC96 of the Basis for Conclusions);

(d) Whether requirements for liabilities of government departments assumed by other entities (presently set out as paragraphs 39-43 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraphs BC97-BC98 of the Basis for Conclusions); and

(e) The practical implications if the definition of contributions by owners and AASB Interpretation 1038 were to be withdrawn?

Response

We have no view on this question as it seems unlikely there would be such instances in Universities.

Question 8

In relation to disclosure requirements regarding compliance by government departments with appropriations, do you agree with:

(a) Omitting the requirement in paragraph 64(e) of AASB 1004 to disclose the nature and probable financial effect of any non-compliance by the government department with externally-imposed requirements for the period, other than any non-compliance reflected in material variances between amounts appropriated and amounts expended? (See paragraphs BC99-BC103 of the Basis for Conclusions.)

(b) Extending the scope of the retained disclosure requirements for government departments (i.e. those regarding any non-compliance reflected in material variances between amounts appropriated and amounts expended) to also apply to any other public sector entities that obtain part or all of their spending authority from parliamentary appropriations? (See also paragraphs BC99-BC103 of the Basis for Conclusions.)

Response

We have no view on this question as it is not applicable to Universities.

Question 9

Do you agree with the proposed transitional provisions in Appendix C of [draft] AASB 10XX? In particular:

(a) Do you agree with the transitional provisions for non-financial assets and finance lease assets and liabilities, the cost of which was not measured at fair value on initial recognition; and

(b) Do any other issues warrant additional transitional provisions and, if so, which transitional provisions do you suggest?

(See also paragraphs BC104-BC109 of the Basis for Conclusions.)

Response

Before commenting on the efficacy of transitional provisions, we believe that the recognition of fair value for “below-market” rentals and a finance lease liability is of consequence to Universities. Our operations are conducted on a scale that few other not-for-profit entities match and we therefore manage very unique situations and arrangements.

We believe that most entities usually enter into finance leases to acquire assets after conducting an evaluation of “lease versus buy” options and thus it is a financing decision, often for the acquisition of items of plant or vehicles. On the other hand, Universities principally enter into lease arrangements on concessional terms, often with a government department or instrumentality, to enable them to use real property to enhance the objectives of teaching, learning and research.

These arrangements typically encompass collaboration with another government department or instrumentality and the properties are often used for joint activities. A most common example is the provision of teaching and laboratory facilities in major teaching hospitals, where jointly-appointed medical and nursing staff combine the practice of medicine with the teaching practicums of students. Another example is of access to and utilization of rural properties or specialist agricultural research facilities used in conjunction with Departments of Primary Industry, CSIRO, Co-operative Research Centres (CRC’s) and the like.

These arrangements are often reciprocated on University premises. These facilities are often provided free of charge or with nominal leases, the primary purpose of which is to formalize contractual arrangements other than commercial aspects, between the parties. They are usually not entered into for any purpose other than being operationally beneficial to all parties.

In these circumstances, the decision to enter the lease is not one of financing but one of assisting the University’s mission. Consequently, there is often no commercial market upon which to assess fair value. We maintain that the fair value has already been established by the mutuality of benefit to both parties and that any attempt to determine another value is moot. We maintain that these arrangements should be regarded as operating leases as they do not meet several of the major tests set out in AASB 117. Thus, in these circumstances, we do not believe the lessor intended to make a donation when entering the lease.

General matters for comment

Question 10

Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

- (a) Not-for-profit entities; and
- (b) Public sector entities, including GAAP/GFS implications (discussed above).

Response

We see no other issue, save and except the lease matters expressed in Question 9 above.

Question 11

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

Response

Revenue recognition

We believe that the change from AASB 1004 will better convey the financial results and state of affairs to Parliament and the respective Departments of Education. Further, we believe the greatest benefit will come from the harmonization of statutory and management accounts in respect of revenue recognition as they are often now prepared using different policies. This has necessitated developing accounting process workarounds to actively and separately manage revenue recognition, bringing inconsistency and confusion amongst the university research cohorts.

Both sets of accounts should be based on the same policies, consistently applied. There is extreme confusion and suspicion on the part of many researchers (who care little for accounting standards and manage their projects on a cash basis) believe the accountants are conspiring to remove their funding. This is anathema to University CFO's and governing bodies who are striving to ensure that there is "one version of the truth" and full transparency in all reporting.

Many University governing bodies acknowledge that there is currently a valid case to change a University's statutory accounting policies so that the revenue is recognised over the period in which the research work is performed. However, most choose not to do so because they do not want their audit opinions to record a qualification, believing that a stigma is attached to it; albeit a somewhat technical qualification. Indeed, some have changed their policies and have found that the attendant audit qualification brings little controversy. Examples are Deakin University and University of Melbourne.

Universities prepare their annual report and financial statements for submission to Parliament under their governing legislation. In that respect they differ from statements for other not-for-profits reporting under the *Corporations Act*, who often have an intended audience that includes clients, benefactors, regulators and the public at large.

We see little impact for the users of University statutory accounts and do not believe that the truth and fairness of those accounts is jeopardized by the changes. After all, there has already been an overstatement of revenues and operating results because research grant income has been booked at the time of receipt by adhering to the AASB 1004 standard. We posit that users of the accounts will be better informed because of this transition.

Finance leases of donated assets

Were leased assets to be brought to account as finance leases at fair value, we see the effect on University financial statements as not being material. The only change to the balance sheet is to increase non-current assets and a corresponding increase in liabilities and we see little point in so doing. As there is no future cash flow to an external party for the inflated lease payments, the liability can only be reduced annually by debiting lease liability and by creating a corresponding entry for donations received.

The carrying value of the leased asset would be annually reduced by debiting leasing expense and crediting the leased asset value. As such, expense and revenue are matched each year and there is no impact on the operating result. The exercise therefore seems to have no practical purpose other than artificially grossing up assets and liabilities. Also, having to make consequent narrative disclosures as part of the accounting policy note to the accounts would likely just confuse a reader.

It is contended that there is no real lease liability at all to an external party and that any credit on the balance sheet is more accurately described as being income in advance. Therefore both sides of the transaction are artificial.

Question 12

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

Response

We do not see any potential effect.

Question 13

Unless already provided in response to specific matters for comment 1,9 above, the costs and benefits of the proposal relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

Response

Transitional arrangements and costs of implementation

C2 An entity shall apply this [draft] Standard using one of the following two methods:

- (a) Retrospectively to each prior reporting period presented in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors; or
- (b) Retrospectively with the cumulative effect of initially applying this [draft] Standard recognised at the date of initial application in accordance with paragraphs C4 and C5.

Revenue in advance on research grants

The task of locating and assessing all research contracts is massive. It is not an exercise that we would choose to do as it would be onerous and divert staff from day to day activities, with no financial benefit accruing.

Even small universities will have many hundreds of current individual research projects under way at any time. For the larger Universities, this number will be many, many thousands. To determine the opening position fully and consequent financial statement adjustment, each individual contract has to be found, interpreted and the progress of deliverable ascertained to create the data for the initial adjustment to asset and liability accounts. This will be a mammoth task and very costly to implement. We cannot quantify what the cost would be as it depends on which staff and how many become involved.

We do not believe that such a task could be simplified through the consideration of materiality as it would still require assessment of a large number of projects in order to achieve a material sample.

Despite the implementation of a new standard, there will be inconsistencies in the audit approach and opinion taken by the respective national, state and territory Auditors-General on the way in which any initial entry can be calculated.

We recommend that either one of the two approaches set out below be adopted. Firstly, given that the research grants are inevitably fully expended (and most often, overspent) over the course of the project, that the amount of expenditure incurred up to the date of the standard's implementation be used to as the basis to determine how much revenue should have already been booked had it been recognised as earned. The balance of expense yet to be incurred is used as the basis for calculating revenue in advance and the consequent balance sheet adjustment.

Secondly, no transitional adjustment is made at all for grants already in existence and that the new basis of recognition is applied to all new grants that are awarded after the implementation date. This will diminish in quantum as the tail of research is worked through to project conclusion.

Recognition of gifts and bequests

Many Universities have received and will receive substantial donations in the form of gifts or bequests. In many cases, these donations are required to be invested in perpetuity by the University with the investment income (over and above that required to maintain the real value of the gift) to be made available for the purpose intended by the donor.

When evaluating such a gift under AASB 15 or AASB 10XX, it is probable that the corpus of the donation will never be able to be booked as income. This is because of the contractual or testamentary requirement that the corpus be maintained in perpetuity by the University (noting that different universities will have different policies, processes and arrangements for such

donations and may arrive at differing conclusions re accounting treatments.) If the corpus is required to be maintained in perpetuity, by definition, the obligation can never be met and therefore the income can never be realized.

Most Australian Universities have such endowment funds and some are in the order of \$1.0b. On implementation of the standard (assuming adoption in its current form), Universities will be required to transfer that corpus amount from Equity to Liabilities, in the form of deferred revenue. This is a further substantial reshaping of the University's balance sheet that would be confusing to users and that generates no useful information.

Further, and very importantly, that portion of the University's investment income that is necessary to maintain the real value of the endowment will no longer be able to be classed as income and will be required to be credited instead to the deferred income liability on an ongoing basis. The resulting impact on the University's published income would be substantial and alarming to the users of the financial statements and would not in any manner portray an accurate reflection of the university's financial performance or position.

We are therefore strongly of the view that the draft standard, as it applies to perpetual gifts would not create value or greater clarity for either the university sector or the users of their financial statements.

Fair value of lease arrangements

It cannot be assumed that the legal documents which conveyed tenancy to Universities are extant or can be readily retrieved. It is a common fact that the devolved nature of Universities means that such documents are often widely dispersed. This will bring a significant and very expensive cost and workload burden if they are to be retrieved or recreated. This is especially the case if the agreements are not recent.

This will be a major distraction to the small number of staff in University Legal Department and they already have high workloads dealing with current matters.

Out of pocket cash costs

Valuations

Were Universities required to compute the amount of a donation element and there was a valid commercial market, it seems likely that the services of a consultant valuer would be required. These services are not inexpensive and are indeterminate. However, they would represent a real cash cost to the University for no tangible benefit.

Audit fees

We cannot form an opinion as to whether or not additional audit fees would be incurred in opining on the transitional adjustments.

Conclusion

Generally speaking, the proposals, as a whole, are supported. We recognise that each respondent and industry sector will have varying and diverse contexts in which they operate. Some Universities will no doubt make specific individual submissions, as is their right. Our submission has been drafted to convey the general response by our members and has been collaboratively compiled with input from ten Universities throughout Australia. Whilst we do not seek special status for Universities, the financial scale and breadth of our undertakings place us in a different context that that of say a small community service not-for-profit entity.

We would be pleased to provide further information, either in writing or in person, to the AASB and its staff and thank you for the comprehensive consultation process that you are undertaking.