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Dr Keith Kendall
Chair
Australian Accounting Standards Board
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Our ref Submission - ED 318
Contact Heng, Kim (+61 2 9455 9120)

10 March 2022

Dear Dr Kendall,

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

We are pleased to have the opportunity to comment on *Exposure Draft 318: Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases.* We recognise that many stakeholders in the not-for-profit sector have encountered complexities in applying these requirements and we welcome the AASB's efforts to provide additional guidance.

We support the AASB's decision to make permanent the temporary optional relief provided to private sector not-for-profit entities as it pertains to concessionary leases initially afforded in *AASB 2018-8 Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*. We believe the recognition, measurement and disclosure requirements provide the right balance on a cost benefit basis for not-for-profit entities.

We also support a continued focus for guidance on the recognition and measurement of income of not-for-profit entities. We are, however, concerned that the proposed amendments relating to the illustrative examples may not clarify the issues and concerns raised by stakeholders. In addition, we believe the proposed examples are too generic and may not provide useful guidance to stakeholders. In this regard we recommend that these proposed amendments be deferred and dealt with more wholistically as part of the upcoming post implementation review of AASB 1058 *Income of Not-for-profit Entities*.

Should the AASB decide to progress with the proposed amendments, we provide insights in the Appendix to this letter that we believe need to be addressed prior to finalising. In particular, we recommend the AASB consider more realistic scenarios that are encountered by this sector to provide maximum benefit to stakeholders.

We have set out our detailed comments on the specific questions to the exposure draft in the Appendix to this letter.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact Julie Locke on (02) 6248 1190, or myself on (02) 9455 9120.

Yours sincerely

Kim Heng
Partner

Appendix

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.***

Our comments on the illustrative examples proposed are set out below.

Accounting for upfront fees – Example 7A
We agree that the proposed Example 7A provides appropriate application of the recognition and measurement requirements of AASB 15, except as noted below.

Whilst we do not have concerns with the application of accounting principles in the example provided, we consider the example is too generic in nature and may therefore not be that useful to preparers of financial statements trying to apply this guidance. We also have concerns as to whether this illustrative example provides additional guidance over and above that already contained in AASB 15 *Example 53 – Non-refundable upfront fee*. To be of greater use to the not-for-profit sector, we believe FAQ 12 (non-refundable upfront school fees) in the *AASB Staff FAQs: AASB 15 Revenue from Contracts with Customers, AASB 1058 Income of Not-for-Profit Entities and AASB 16 Leases* (March 2022), with its specificity, may be a more realistic, practical, and useful example that could be used to illustrate the relevant accounting principles. We understand that part of the generic nature of the proposed example was that non-schools dismissed the example as they did not understand a direct correlation to their circumstances. We consider this could be addressed by an introductory paragraph around the types of non-refundable upfront fees this analysis could be applicable to.

We also note an inconsistency against AASB 15 paragraph B51. In the subtitle, "How is the revenue for the upfront fee recognised?" the exposure draft notes, "if an entity has charged the non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative task) and those setup activities <u>are not a separate performance obligation</u>, they should be disregarded when measuring progress towards completion of services" (emphasis added).

Paragraph B51 states: "An entity may charge a non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks as described in paragraph 25). <u>If those setup activities do not satisfy a performance obligation, the entity shall disregard those activities (and related costs) when measuring progress</u> in accordance with paragraph B19. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity shall assess whether costs incurred in setting up a contract have resulted in an asset that shall be recognised in accordance with paragraph 95." (emphasis added). We recommend the example is aligned to the wording in B51, that is, replace “are not a performance obligation” with “do not satisfy a performance obligation” to remove any ambiguity in its application.

Accounting for financial liabilities - Amendments to Illustrative Example 3
We agree that the current illustrative Example 3A in AASB 1058 is unclear and does not sufficiently explain whether recognition of a financial liability is required.

We agree this is a significant issue for stakeholders, however, we question the usefulness of the example provided. We commonly see in practice that the principal amount of the endowment is invested and preserved, while the interest earned from this principal is used, for example in this case, the provision of scholarships and subject to scholarship conditions. The principal itself generally remains within the control of the university and is not distributed for scholarship funding. We believe the demonstration of the accounting principles using an example from practice would be most beneficial to users of the standard. Given the complexities of this example, we question whether it may be more beneficial to address the issues raised by stakeholders in this example more wholistically as part of the upcoming post implementation review of AASB 1058, rather than seek to amend it as proposed.

Furthermore, whilst we do not disagree with the accounting outcome in Example 3A.2, we do question the usefulness of this scenario. We believe that Example 3 as a whole, should compare and contrast more realistic and complex examples of when a financial liability should be recognised. Currently, we view Example 3A.2 as too simple and easily derived based on the accounting principles without need for demonstration and therefore does not provide much insight for users of this standard. We believe an example where while the university has the discretion on awarding the scholarships to particular students, there is some conditionality in the endowment agreement on the use by students of the scholarship funds (such as for computer or IT resources), which would be more beneficial to users of this standard.

If the AASB does proceed with this example as part of this amendment, then we believe that further clarity is still needed to remove ambiguity in the amended illustrative example. Our main concerns centre around the following:

i) Within Example 3A.1, the illustration contemplates whether the derecognition of a financial asset is appropriate as opposed to the recognition of a financial liability. *“The university also considers whether derecognition of the financial asset is appropriate …instead of the recognition of a financial liability.”* In this example, there is only one event which is the contract with the alumnus, raising the question as to whether a financial asset, and a corresponding financial liability, income or equity, or a mixture should be recognised. It is unclear what the trigger event or transaction is with the alumnus that would result in the financial asset being derecognised.

ii) The terms of the endowment provided need further clarification, in particular to consider if the alumnus can direct the full amount at any time within the 10 year period, that is, “on demand”. Currently, the terms of the example imply this amount is on demand given the recommendation is to recognise a $2 million endowment financial asset and “*an equal amount as a financial liability”*. However, for purposes of valuing the financial liability under AASB 9, the present value of the cash flows and time value of money need to be considered. The example notes that the endowment is at the direction of the alumnus over the next 10 years, however, does not stipulate the timing of such direction within that period. For example, can the entire amount be directed to students within the first year at the discretion of the alumnus, or will it be evenly directed over 10 years (which would result a lower fair value due to the time value of money)? This has implications on the accounting of this endowment at initial recognition. For example, if the endowment is to be directed to students evenly over the 10 years, the present value of these amounts would be the fair value of the financial liability, and the residual would arguably be recognised as income at initial recognition.

iii) To aid in the illustration of the treatment, we believe inclusion of journal entries throughout the endowment period would be useful, similar to Example 3A.2. In particular, this would clarify the accounting of the interest earned from the principal over the 10 year period, the accretion of the liability over time, and how subsequent payments of scholarships would be recognised. This will assist the readers’ understanding of the intent of the AASB on the application of this requirement as there are some concerns of the perceived usefulness of the financial statements if the subsequent accounting results in the ‘collapse’ on an entity’s profit and loss, i.e. there would be no subsequent recognition of amounts relating to the payment of scholarships in the profit and loss.

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 agree with AASB's proposal to keep the accounting policy choice in AASB 16 as they relate to concessionary leases on an ongoing basis for not-for-profit private sector entities.

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 provide sufficient information for users of the financial statements and that no further disclosures are required.

4. ***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.

Not applicable – we agree with AASB's view in question 2 as noted above.

If the AASB does decide to use a fair value approach, we believe this should be applied prospectively in respect of new leases to align with the practical expedient provided on transition to AASB 1058 under paragraph C8 for 'Assets acquired for significantly less than fair value'.

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.

We agree that the disclosures provide sufficient information to users of public sector not-for-profit entities and no further disclosures are required.

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?

We agree the process in issuing the exposure draft is consistent with the AASB Not-for-Profit Standard Setting Framework.

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?

We are not aware of any specific issues.

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

We are not aware of any specific issues.

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

As set out in question 1 above, we are concerned that the application of the proposals in Illustrative Example 3A.1 may not result in financial statements that would be useful to users.

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

We do not have any specific comments on whether the proposals are in the best interest 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? 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.

We do not have any specific additional comments on the costs and benefits of the proposals.