

Submission to AASB Exposure Draft 260 by the Australian Government Department of Education and Training

18 August 2015

The Australian Government Department of Education and Training (the department) produces *The Financial Statement Guidelines for Australian Higher Education Providers* (the Guidelines) which prescribe the form of the financial statements approved by the Australian Government Minister for Education, or their delegates, under section 19-10(2) of the *Higher Education Support Act 2003* (HESA) and section 58 of the *Australian Research Council Act 2001* for listed higher education providers (s16-10 of HESA). These listed higher education providers include all Australian public universities, the University of Notre Dame Australia, Bond University and the University of Divinity (41 universities in total). All of these universities are not-for-profit registered charities.

The Guidelines include an illustrative set of financial statements to highlight disclosure requirements and provide sample disclosures. They aim to enhance transparency, consistency and comparability across the university sector, and align university reporting with good practice commercial reporting with regard to the needs of the sector. University financial statements that are compliant with the Guidelines are also compliant with all Australian Accounting Standards applicable to NFPs. The Guidelines are located on the department's website here: <http://www.education.gov.au/financial-statement-guidelines>

The department has provided this submission based on its views of ED260's impact on the Australian university sector from the point of view of a regulator. The department is aware of the Australian Senior Finance Officers Group's (AUSFOG) submission to the AASB on ED260 and has considered the opinions provided to it by the sector in forming its response.

1) In relation to the AASB's 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's financial performance?
- b) if not, what alternative approach to income recognition would you recommend for not-for-profit entities? Please provide your reasons.

a)

- AASB 1004 *Contributions* does not provide appropriate recognition and measurement of grant revenue for universities. An alternative to this is welcomed. The department is in favour of AASB 15 and AASB 10XX if they result in a different treatment of grants from AASB 1004.
- AASB 1004 requires universities recognise government grant income, for example a capital grant to build a building, at the time of receipt. This does not reflect the nature of the grant and the related expenditure is recognised over several subsequent reporting periods, as the building is completed. This can result in large fluctuations in university profit and loss from one reporting period to the next, causing potential overstatement of profit, understatement of liabilities and anomalies in trending data. Some universities have chosen to not adopt AASB 1004 and accept a qualification on their financial statements from their Auditor-General, e.g. The University of Melbourne and Deakin University.
- The department would like to see consistency in accounting treatment for all government grants. It is important to the sector that there is no ambiguity in how a grant is to be recognised or measured. The Australian university sector is small and the department has been working for quite a number of years to have universities report on a consistent basis, not only from one period to the next but within the sector for comparability. The ability to make a subjective decision on grant income reporting will undermine the consistent and comparable approach that the department has worked to foster.

- Satisfying a performance obligation under AASB 15 will require enforceable rights and obligations that are sufficiently specific.
 - Providing these characteristics are clearly defined, and alleviate the inconsistency in income and expense recognition caused by 1004, the department is in favour of this approach.
 - At round table discussions it was clear that different readers of ED260 had drawn varying conclusions about the interpretation of these elements.
 - There is cause for concern around ambiguity of the existence of performance obligations and the ability to measure whether they have been met or not as to how and when the income should be recognised.
 - There is concern that due to a lack of specificity of some government grant agreements some grants could be categorised under AASB 15 and others would fall under AASB 10XX in line with the treatment of donations (which would be a similar outcome to 1004). The department is not in favour of this result; there needs to be a clear difference between donations and grants.
- b)
- The department does not agree with the opinion of AUSFOG that grant revenue should be recognised over the useful life of the related asset, rather that the income should be recognised as the expenditure is incurred.

2) In relation to the AASB’s proposal that, to qualify as a performance obligation, a not-for-profit entity’s promise to transfer a good or service to a 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-entity has a performance obligation? Please provide your reasons.

- a)
- AASB 10XX is not clear enough on its requirements for a ‘sufficiently specific’ promise, it needs a better definition.
 - There is concern that due to a lack of specificity of some government grant agreements, some grants could be categorised under AASB 15 and others would be treated under AASB 10XX. Grants that do not meet the ‘sufficiently specific’ requirement would be treated in line with 1004. We are not in favour of this result, we would like all grants to have the same accounting treatment, otherwise we have done nothing to alleviate the current issues and have only created further problems with grants being treated differently, not allowing for comparison of the sector.
 - IG13 states the promise must be sufficiently specific to determine when the obligation is satisfied. At the Canberra roundtable UC raised the point that Block Grants and specific research grants may be treated differently under the current proposals. Block grants are for the support of general research activities. Research Grants are for specific research projects. Under the new standard, block grants they might not have specific enough funding agreements or the funds from a particular grant might not be easily tracked within the university. They would be treated as donations. This is not appropriate.
 - The subjective assessment of ‘sufficiently specific’ could create the issue of inconsistent reporting across the sector unless the department specifies in the Guidelines how each individual or groups of grants are to be reported. We do not feel that this is a desired outcome especially in light of the Government’s deregulation agenda and the requirement to reduce red tape and reporting for the university sector.
 - ED260 notes that an acquittals process (IG17) or actual to budget reporting (IG7) does not necessarily mean an obligation exists. How else to you determine when obligation is satisfied under IG13?
 - Someone at the Canberra roundtable interpreted IG15 to mean that a small charity with one objective could receive an operating grant that would fall under AASB 15 because its sole objective satisfies the ‘sufficiently specific’ requirement. As universities are much larger they could not pass this test, is this

inconsistent or does the wording of AASB 15 need to be clarified. Should universities receive an exception/exemption?

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?

- The department acknowledges that AUSFOG agrees with this , but notes there are few circumstances where this applies to universities
- At roundtables the issue of sponsorships was raised. There is room for inconsistency in treatment of sponsorships. E.g. UC has sporting teams that give them free tickets as part of their sponsorship contract, would these be donations?
- This also raises the issue of donated goods or services. If there is no specific requirement to use the goods or services within a timeframe or for a certain purpose, are they a donation and how should they be measured if they have no hard “use by” date?

4) In relation to the AASB’s 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.)

a)

- The department agrees with AUSFOG’s point of view on this that it is too onerous.
- ‘Volunteer services’ requires a definition; does it include ‘in kind’, what if space is donated?
- The department believes requirements should be the same for public and private NFP because some universities have for-profit subsidiaries, and consistency would reduce their reporting burden.

b)

- AASB 10XX will require all government entities to comply with the requirements of AASB 1004.44 and recognise volunteer services, but other NFP’s will be given the choice (BC62)
- Recognition of volunteer services should be consistent. The department would support an optional approach as it does not see that many of the universities would want to adopt this requirement and those that do may be disallowed under the Guidelines for sector reporting consistency.

- At the round table in Canberra it was raised that recording volunteer services is incredibly burdensome and instead belongs in the annual report, not the statements. The department agrees that recording and measuring volunteer services would be an impost on providers.
- We do not suggest that volunteer services information can be useful, but we feel that it does not belong in the audited financial statements, but elsewhere in the annual report.

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.)

- The department shares the opinion of AUSFOG that donations should be captured on entry and class of inventory reassessed at end of period

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.)**

- As this is not applicable to universities we have no comment.

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’s 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?

- As this is not applicable to universities we have no comment.

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 (ie 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.)**

- As this is not applicable to universities we have no comment.

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.)**

a)

- AASB 10XX effectively requires universities to remeasure the initial carrying amount of a non-financial asset as if it had been recognised at FV on initial recognition. This would require universities to look back years to find the initial FV. This is impractical for many universities, some of whom have long leases dating back decades, where documentation might not be readily available.
- We do not believe this adds value to the user of financial statements as university assets will suddenly increase by a material amount as a result of the revaluation without any corresponding increase in the assets’ capacity to produce income or improvement in the university’s financial position. Often these assets are leased or gifted under conditions which restrict their use or do not enable them to be later sold. We do not believe that the additional disclosure is worth the additional cost and burden on the universities.
- Would we prefer to instead remeasure it at FV for the end of the first period that 10XX is applied instead? While this would reduce the reporting burden on universities, again we wonder what value it will add to users of financial statements. For example if the University of Sydney holds its plant and equipment, library and non-commercial teaching and research land, buildings and infrastructure at cost. If it was required to suddenly revalue these assets at fair value, their book value would increase substantially without any improvement in other factors which may be misleading to users. AASB 13.27 FV says value it at highest and best use, however some CBD located universities might not be using their assets for the ‘best use’, e.g. knocking down a lecture theatre and building a shopping centre might be a better use, but does using this value instead really produce better information for users?
- The department keeps statistics on individual and whole of sector university financial information. This change would be large enough to potentially render previous years’ balance sheet data incomparable with future years. The data the department keeps is also not retrospectively changed to reflect restatements to

previous years. This is a problem for the users of our information which includes government, universities, researchers and students.

b)

- We acknowledge that AUSFOG holds the opinion that all older grants are still treated under AASB 1004 and any new grants after the implementation date be dealt with under AASB 15 and 10XX. Their reasoning is based on the substantial burden of going through all the grant/research funding they have received and funding that is currently ongoing, particularly as many universities are large devolved organisations.
- We do not support this position as it is not consistent and do not see a requirement for any transitional provisions. We feel there should be a line in the sand. Grants received in previous periods should have already been recognised in those periods and should not be recognised in future years even though expenditure may be still ongoing.

General matters for comment

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).**

- The department requires that universities comply with AASB 1004, however this makes them non-compliant with IFRS. As some universities have international operations this does cause some additional regulatory burden.
- The University of Melbourne and Deakin University accept qualified audit reports each year due to their non-compliance with 1004 and the Guidelines issued by the department. An alternative to 1004 is welcomed if it changes the recognition and measurement of government grants more in line with their use.

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

- The removal of AASB 1004 will result in more useful university financial statements for users if it is replaced with an alternative that allows measurement and recognition of grants as the performance agreements are met or as the grants are expended.
- In the year ended 31 December 2014 the University of Melbourne reported that due to its non-compliance with AASB 1004 its liabilities were overstated by \$217 million, income was overstated by \$9 million and retained surplus overstated by \$226 million (the university had net assets of \$4.45 billion at 31 December 2014). There is a larger impact on smaller universities that are more heavily reliant on government funding.
- About 59% (\$15.43 billion) of the sector's income from continuing operations (\$26.33 billion) came from Australian Government financial assistance in 2013.
- Universities often report their profit under Australian Accounting Standards and then an underlying profit that adjusts for the issues caused by AASB 1004 and other timing factors that they consider may be misleading to users. There is not currently an agreed sector-wide way of calculating underlying profit, nor is it expected that there will be agreement on a calculation any time in the near future. This results in universities reporting two numbers, one of which is not consistent with other universities or AASBs, which are repeated by the media. There is a project between universities to reach agreement on a methodology for calculating underlying profit and this has not yet been achieved, so agreement on a single method of calculation may never be achieved.
- If the problems caused by 1004 are not rectified in the new AASB 15 and 10XX there will be very little benefit to users.

- The requirement to revalue below market and gifted assets retrospectively and hold them at fair value will cause considerable reporting burden for universities, but we do not believe that it will result in better financial information for users. It may result in incomparability with older data which has been recorded on the sector.

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

- We have no comment.

13) Unless already provided in response to specific matters for comment 1 – 9 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.

- The department acknowledges the opinion of AUSFOG in this respect and would agree with their concerns about treatment of donations that are held in perpetuity, and the burden of restating comparatives due to the high volume of research projects and grants. Some of the proposed changes would require the engagement of a consultant valuer.