ACT Government
Chief Minister, Treasury and Economic Development

Ms K Peach
Chair
Australian Accounting Standards Board
PO Box 204
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VIC 8007

Dear Ms Kris Peach

Exposure Draft 283 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Public Sector Licensors*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on its Exposure Draft 283 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Public Sector Licensors.*

There are varying views from the members on certain aspects of the exposure draft as discussed in the attachment to this letter.

HoTARAC recommends the AASB reconsider the following areas specifically:

- the impact of the exposure draft on the classification of tax and non-tax revenue and avoiding the creation of additional divergences with Government Financial Statistics requirements; and
- the concepts in paragraphs G17-18 and Example 8 of the Illustrative Examples on distinguishing performance obligations and mere features of an arrangement.

The attachment to this letter sets out HoTARAC's responses on the specific and general matters for comments. If you have any queries regarding our comments, please contact Kristine Malacad from NSW Treasury on (02) 9228 5057 or by email at kristine.malacad@treasury.nsw.gov.au.

Yours Sincerely,

David Nicol
Chair
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

9 April 2018

HoTARAC agrees with the objective of the exposure draft to provide guidance on revenue from non-IP licences. However, we have a number of concerns that are included in our responses below. In particular, we draw your attention to the views in "Other Comments" in respect of identifying specific performance obligations.

SPECIFIC MATTERS

1. Do you agree to expanding the scope of AASB 15 to include non-contractual licences (ie arising from statutory arrangements) (paragraphs 4, G7-G9)? If not, please provide your reasons.

HoTARAC agrees.

However, one jurisdiction disagrees with expanding the scope of AASB 15. In their opinion, the licences issued by the government are unique in nature and only apply to arrangements underpinned by the coercive power of the state. They are not the same as a voluntary transaction between two independent parties that both benefit from the transaction. They should not be included in AASB 15, but dealt with separately i.e via AASB 1058 *Income for Not-for-profits*.

2. Are you aware of any lease arrangements that would arise from statutory arrangements rather than a contract? If so, please provide details of these arrangements and their accounting treatment.

The Port of Melbourne transaction arose from legislation and was classified as an operating lease for GFS purposes.

3. Do you agree with the requirements for not-for-profit public sector entities set out in paragraphs G10-G13 which specify that: a) IP licences shall apply the guidance in paragraphs B52-B63B of AASB 15; and b) non-IP licences, that are not a lease and are distinct from other goods or services, shall be accounted for as a separate performance obligation under AASB 15? If not, please provide your reasons.

HoTARAC agrees.

Please note the disagreement of one jurisdiction in response to Question 1.

4. In relation to the AASB's proposal in paragraph 4 and the guidance in paragraphs G19-G23 of this Exposure Draft ('Recognition exemptions'), to include practical expedients in the Amending Standard to account for revenue from short-term or low-value licences issued by not-for-profit public sector licensors:

(a) do you agree that this proposal would provide relief to preparers while retaining a faithful representation of a not-for-profit public sector licensor's financial performance? Please provide your reasons.
(b) if not, what alternative practical expedient approach (if any) to income recognition would you recommend for not-for-profit public sector licensors? Please provide your reasons.

HoTARAC questions whether the proposed practical expedients offer any substantive 'relief' for preparers and will simply lead to inconsistency in revenue recognition across jurisdictions. The majority of licences issued by the jurisdictions are short-term or low-value licences and HoTARAC believes that the existing accounting treatments for these licences, which are in line with the proposed expedients provide a faithful representation of the respective financial performance.

Some low value licenses have a high volume of transactions, meaning the revenue is material. Permitting options to recognise revenue on either an upfront, straight-line or other systematic basis, could lead to inconsistencies in how material revenue streams are reported. Consideration should be given to narrower requirements to ensure the treatment somewhat aligns with the licensor's obligations or removal of the practical expedients.

5. In relation to licences issued by not-for-profit public sector licensors that are not intellectual property (IP) licences (ie non-IP licences) that involve sales-based or usage-based commission:

(a) do you agree with the AASB's proposal to use the general guidance in AASB 15 paragraphs 56-57 ('Constraining estimates of variable consideration') to determine the transaction price for the licensing arrangement, which in turn would determine the timing of revenue recognition? Please provide your reasons.
(b) if not, as an alternative, do you believe the general guidance in AASB 15 should be amended to reflect for non-IP licences, the guidance for sales-based or usage-based royalties set out in paragraph B63 of AASB 15 for IP licences? This guidance may make it easier for licensors to determine the transaction price and timing of revenue recognition of non-IP licensing arrangements involving sales-based or usage-based consideration. However, this would mean that the accounting for non-IP licences by not-for-profit public sector entities would be different from that for other entities (which would not be transaction neutral).

In principle, HoTARAC believes that the public sector treatment for non-IP licences should be consistent with the for-profit sector. Therefore, we would prefer that non-IP licences based on sales or usage are treated the same as for-profit in option (a) above. However, we note that in the event option (a) is adopted and the revenue cannot be reliably measured, then option (a) would give the same outcome as option (b) because the revenue could only be recognised after the subsequent sale or usage occurs.

It should be noted that HoTARAC members consider licence fees and royalties arising from conducting licensed activities as separate revenue transactions, and do not consider the royalties to be contingent consideration.

6. In relation to non-IP licences issued by not-for-profit public sector licensors, do you have examples of distinct licences issued that involve a non-identified asset or assets of the licensor (ie that are not leases)? Please provide the details of your example. If you do have an example, do you think the specific guidance in paragraphs B52-B63B for IP licences may also be useful to help account for the licence in your example? (Paragraphs G14-G15)

As an overarching comment, HoTARAC does not agree that paragraphs B52 to B63B of AASB 15 fully supports the accounting considerations in connection with non-IP licences. We are of the view that more guidance is required to identify the performance obligations within the licencing arrangements and particularly to identify the ongoing activities that maintain the value of the arrangement for the licensee. HoTARAC requests the AASB reconsider the application of AASB 15 to non-IP licenses, recognising that the AASB 15 application is not necessarily fit-for-purpose. The AASB should include additional guidance in the exposure draft to support the nature of the performance obligations within non-IP licences.

HoTARAC requests the AASB clarifies whether the "non-identified assets of the licensor (i.e. that are not leases)" refer to assets that are "controlled" for accounting purposes (i.e. on balance sheet) or "controlled" but are not recorded on balance sheet i.e. navigable waters. The following are examples of non-IP licences that involve on and off-balance sheet assets of the licensor that are not considered leases:

- Mooring fees
  Private mooring fees permit individuals to moor vessels on navigable waters. Renewed annually, this licence is not a lease of the seabed and there is no guarantee of tenure. The general position of the site is determined (and may be varied) at the discretion of the government agency. Mooring fees are recognised as revenue upon receipt as they are valid for a period of 12 months.

- Road occupancy licence
  Road occupancy licences are required for any activity likely to impact on traffic flow, even if that activity takes place off-road. The government agency directs the use of the area to be occupied. Road occupancy licences are recognised as revenue upon receipt.

- Aquatic licence
  Aquatic licences may be required for organised activities on, or in, navigable waters. This may also include the exclusive use of an area of navigable water for the conduct of an aquatic activity. The government agency directs the use of the area to be occupied. Aquatic licences are recognised as revenue upon receipt.

HoTARAC considers that the guidance in paragraphs B52-B63B for IP licences is relevant to the examples above. However, these examples are of low value and HoTARAC considers that the proposed practical expedients may apply.

In the example provided in paragraph G15, HoTARAC disagrees with the concept in the commercial fishing licence example where the licence is not considered distinct from other goods and services. In a commercial fishing licence, the licensor's obligation is to grant the licensee the right to perform a commercial activity. It does not promise the licensee to transfer the fish, as the fish is not a commodity for sale and the fee is not refundable if no fish are caught. Once a licence has been

granted, the licensee is expected to comply with the requirements of the licence. The government agency monitors compliance with the requirements and imposes a fine for any non-compliance.

ED 283 does not define or explain what a 'take or pay' arrangement is, or how it is different to a licence. HoTARAC proposes clarifying the concept of 'take or pay' arrangements in paragraph G15 and the accounting treatment for such arrangements.

7. Do you agree that the features outlined in paragraph G3 to determine a tax from a licence provide sufficient guidance in making this distinction? If not, what other factors may be useful to make the distinction?

HoTARAC requests further clarification on the distinction between a tax and a licence and proposes that AASB consider the guidance from the Australian Bureau of Statistics (ABS) on determining tax and non-tax revenue.

HoTARAC notes that the primary criterion under GFS in determining whether a fee is a tax is the extent to which the purpose is to raise revenue. Where a fee is out of proportion to the cost of providing the service, this result in a tax under the GFS framework.

HoTARAC notes that the consideration in Example 8 of the exposure draft is a tax under GFS, as the fee raised is not proportional to the cost the government incurs. The exposure draft classifies the non-refundable part of a fee as a tax, while GFS recognises the practical difficulties in this approach and treats the non-fundable fee as either a tax or non-tax based on the predominant nature of the revenue.

HoTARAC would urge the AASB to avoid creating additional divergences with GFS where this can be avoided.

HoTARAC notes that the accurate measurement of the government's taxation revenue is vital to a range of economic indicators, including the tax to GDP ratio. The AASB should carefully consider any proposal that potentially allows a government to reduce taxation revenue through redefining a tax as a licence whenever the government provides some benefit to the fee-payer.

8. Are you aware of any for-profit public sector licensors issuing non-IP licences? If so, please provide details of these licenses and their accounting treatment, and comment on whether the scope of this Exposure Draft should be extended to for-profit public sector licensors?

HoTARAC is not aware of any for-profit public sector licensors issuing non-IP licences.

GENERAL MATTERS

9. Whether *The AASB's Not-for-Profit Entity Standard Setting Framework [draft]* has been applied appropriately in developing the proposals in this Exposure Draft?

HoTARAC agrees.

Please note the disagreement of one jurisdiction in response to Question 1.

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

HoTARAC proposes that the AASB consider the guidance from the ABS on the distinction between tax and non-tax revenue in order to promote consistency and avoid additional reconciliation procedures.

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

HoTARAC agrees that providing a guidance that would promote consistency in reporting across the not-for-profit public sector would be useful to users. However, we draw attention to our comments on the distinction between taxes and licences and the identification of specific performance obligations as further discussed in "Other Comments" below.

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

HoTARAC has no comments.

13. 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.

Comments included above where appropriate.

OTHER COMMENTS

HoTARAC recommends the AASB reconsider the concepts in paragraph G17-18 and Example 8 of the Illustrative Examples on the basis of the following:

- The existing exposure draft takes a unilateral decision to exclude the actions taken by the licensor (to maintain the value in the licence) from being considered as performance obligations and instead records these as 'features of the arrangement' without rationale or justification;
- The exposure draft fails to recognise the substantive nature and effect of the obligations of the licensor; and
- Example 8 fails to recognise the complexities of gambling / casino licences, the substantive performance obligations contained within these arrangements (outside of providing exclusivity) and the value that the licensee obtains from these obligations.

The substance of these licence arrangements, including gaming/casino licences, are commercially negotiated contracts, whereby the operator/licensee and the State/licensor agree to a value exchange between the parties for the whole of the licence period.

Other Comments Continued

The ongoing commerciality of these arrangements, throughout the licencing period, is a fundamental characteristic of these arrangements. To ensure the commercial viability and value of these arrangements are delivered/ preserved, the licensor is required to actively manage/sustain the value of these arrangements, beyond exclusivity of the arrangement.

HoTARAC disagrees that monitoring the licensee's compliance with the terms of an arrangement and upholding the integrity of the licence are mere 'features' of the licensing arrangement. AASB 15 paragraph 35 outlines the criteria to be met to transfer control of a good or service over time and, therefore recognises revenue over time. We would argue that under AASB 15 paragraph 35(b) *"the entity's performance creates or enhances an asset [in this instance a licence] that the customer controls as the asset is created or enhanced"* is met and that revenue would be recognised over the term of the licence. In the casino licence example, the monitoring of the licence does not simply maintain the integrity of the licence but underpins the entire credibility and commerciality of the activities of the casino and its brand value. Without ongoing assurance that the licensor provides for the public to engage in fair gambling activities, we would argue that the licence is worth significantly less to the casino operator (licensee).

The extent of the assurance provided to the public is reinforced through a highly visible presence of the monitoring activities with onsite offices in full public view. The ongoing activities creates public confidence that they are participating in regulated gambling activities.

It is our view that these actions to maintain the commerciality of the arrangements are akin to ongoing maintenance obligations that represent 'performance obligations' in accordance with AASB 15. The actions required by the licensor are 'active' and not 'passive' – without the active involvement of the State, there is a risk that the commercial value of the arrangement will not be upheld, potentially exposing the licensor to legal action from the licensee. In this respect, the licensor's activities:

- serve to maintain confidence in the services, systems and operations of the licensee, upon which the commerciality of the arrangement is underpinned; and
- if not performed would substantially detract from the commerciality of the arrangement.

Without recognition of the activities that the licensors need to fulfil and the commerciality that this provides, the exposure draft will not provide the clarification on non-IP licences that it is seeking to achieve.

It is also important to note that the current accounting practice by preparers, which is supported by auditors, is premised on the fact that there are substantive, ongoing performance obligations.

One jurisdiction, however, agrees with the exposure draft that such exclusivity arrangements discussed above do not have performance obligations. Nevertheless, they propose that AASB reconsider the use of casino licences in its example as these licences are complex and hold little relevance outside the government not for profit sector. This is in contrast to the majority's position where they consider the complexity of a casino licence as a strong case in drawing out the inconsistencies in applying the key principles