Approach (b)

- The IPSAS requirements in IPSAS 23 were not developed with similar principles to AASB 15 and the IPSAS is developing a new method for recognising revenue/income in the public sector.
- The AASB highlighted concerns with IPSAS 23 in paragraphs BC12 -BC14 of the Basis for Conclusions of AASB 1058 and considered that basing the income for not-for-profit entities on existing IPSAS would not meet the objectives of the project.

Approach (c)

- The recognition principle used by AASB 120 is for grants that are narrow in scope and will not work for the various types of grants that are received by not-for-profit public sector entities.
- The AASB highlighted concerns with extending the scope of AASB 120 to NFP entities in paragraphs BC15-BC17 of the Basis for Conclusion of AASB 1058.

ACAG notes that if approach (d) is adopted it may reduce some of the burden of making complex judgements and may bring the revenue recognition closer to the matching concept. However, some jurisdictions:

- consider this as a step back, from the revenue recognition model in AASB 15 which is linked to the identification of SSPOs
- will involve educating the constituents on new requirements and may involve significant time and cost.

Some jurisdictions note that even under the alternative approaches, there are some agreements that are unlikely to meet the requirement of an obligation under a binding arrangement to spend funds on specific projects or activities, or eligible / allowable expenditure. For example, Commonwealth Financial Assistance Grants to local governments, which do not set out any obligations or activities to be performed. For example, some local governments in various jurisdictions include a disclosure in their financial statements for transparency to highlight the financial assistance grants received from the Commonwealth that are recognised in the current year that relate to the following financial year.

## Topic 4: Principal v agent, including the appropriate recognition of financial liabilities

| **Questions 11 and 12** |
| --- |
| Regarding the recognition of financial liabilities, if an NFP entity's only obligation is to transfer funds received to other entities, do you have any comments on:<br>11. the determination of whether the entity is a principal or an agent?<br>12. whether differences in application exist in concluding whether an NFP entity is a principal or an agent? If there are differences in application, do they significantly affect the comparability of financial statements?<br>If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful. |

Controlled versus administered

A key issue faced by the NFP public sector is the application of the principal versus agent concepts when applying AASB 1050 'Administered items'. Administered items are classified as such when the entity performs activities on behalf of another entity within the government (or the Crown itself). If an item is administered on behalf of another government entity of the State, then the amounts are recorded off-balance sheet, which differs from when an entity is acting as agent when a financial liability may be recognised. The lack of guidance and the extent of judgment required in applying AASB 1050 leads to challenges in its consistent application by government entities. One jurisdiction's Treasury has mandated that AASB 1050 be applied by all general government sector entities and not just departments.

ACAG believes it would be beneficial for the AASB to consider principal versus agent along with any feedback provided in relation to this PIR in the post implementation review of AASB 1050 'Administered Items'.

In one jurisdiction the current practice is for appropriations for statutory bodies to be recognised in the administered financial statements of the respective departments (as only departments can receive appropriations). This accounting is based on the interpretation that the administered financial statements need to apply accounting standards, including AASB 1058. This practice also requires the department to prepare budget versus actual financial statements (Income Statement, Balance Sheet and Cash Flow Statement). The jurisdiction believes that the inclusion of such pass-through appropriations does not appear to provide useful information. In some cases, the recognition and disclosure of pass-through appropriations obscures the real operations of the administered activities.

The legislative framework for appropriations varies between jurisdictions. For example, the above contrasts with another jurisdiction where the department controls appropriations to other entities in their administrative cluster and recognises these as controlled rather than administered in their financial statements. Refer to the examples below for more details.

Pass-through grants

Some jurisdictions have found that there is often a significant amount of judgement and debate as to whether 'pass-through' grants, are actually a 'pass-through' (i.e. the entity is acting as an agent), or whether the administrator has a performance obligation to administer the grants appropriately (i.e. acting as a principal). In some instances, the grant administrator has little discretion as to whether to distribute the funds to people or organisations meeting the eligibility requirements, yet they are responsible for checking the eligibility, and for marketing the grant's availability.

Pass-through funding also exists in the state government for Commonwealth grants, such as grants to non-state government schools, and grants to local governments.

In practice there are inconsistencies within the jurisdictions on how this funding is accounted for. For example, grant funding for:

- non-government schools are accounted for as controlled by one jurisdiction, as administered by two jurisdictions and neither controlled nor administered by one jurisdiction as the Treasury in that jurisdiction provided guidance that payments made to eligible recipients by the State Government on behalf of another entity (e.g. the Commonwealth Government) under a pass-through arrangement should not be recognised as administered income and administered expenses
- local governments are accounted for as administered by three jurisdictions and neither controlled nor administered by one jurisdiction, for the same reasons outlined above.

Example 3A of AASB 1058

As highlighted in ACAG's response to AASB Exposure Draft 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases* (ED 318), we have significant concerns with the current example 3A of AASB 1058 and the replacement example proposed in ED 318.

AASB 9 applies to all financial instruments, except those that are specifically excluded under paragraph 2.1. Under AASB 9 Appendix A, and AASB 132 *Financial Instruments: Presentation* paragraph 11, a 'financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity'.

The majority of ACAG jurisdictions do not believe that on the university's receipt of the endowment funds, there is a financial liability, or a contractual obligation to pay cash. Before there is an obligation to pay cash, a suitable student recipient needs to be selected. It is only after the suitable student is selected, and agrees to any scholarship terms, that there is an obligation to pay cash to the student. In practice, such payments are often conditional, as there are conditions associated with receiving a scholarship, such as good behavior, and achieving suitable grades.

Also, the majority of ACAG jurisdictions do not believe that on the university's receipt of the endowment funds, the scholarship recipients have a contractual right to receive cash from the university. A student will have a right to receive cash when they are selected as a suitable recipient by the university.

Consequently, on the university's receipt of the endowment funds, neither a financial liability of the university, nor a financial asset of another entity to receive cash from the university exists. Therefore, the definition of a financial instrument is not met.

Further, the university is making the decisions about to whom the scholarships should be granted – having discretion is indicative of a 'principal' (noting that this differs from the way in which AASB 15 determines who is a principal)[1].

However, if the grantor had specified to whom the scholarships must be provided and for what amount, it would seem appropriate for the intermediary grant recipient not to recognise the amount as revenue/income (in effect they are merely acting as an agent and have no discretion on how to allocate the funds) but instead recognise a financial liability. However, where this is within the controlled activities of an entity, the majority of ACAG jurisdictions do not believe the definition of a financial instrument has been met (i.e. there is no financial asset of another entity at that time).

There are a number of grant and loan programs within government to which this issue is relevant.

ITC Foundation Example

Some jurisdictions found the Foundation example in the ITC unrealistic. In practice there is often no obligation (per existing accounting standards) to pass all funds raised to other organisations, even though that may be an intention. There is also often no agreement with those organisations as to how much will be retained to cover administrative and marketing costs. These jurisdictions do however acknowledge that there are service providers that do raise money for charities on a commission basis where the responsibilities are clearly outlined.

| **Question 13** |
|---|
| In relation to determining whether an NFP entity is a principal or an agent, do you have examples of specific scenarios where there are practical challenges and application issues?<br><br>If so, please provide details of the complexities associated with this determination, such as the level of discretion the entity has in determining to whom funds will be passed, and illustrate the relevant circumstances, their significance and the prevalence of any differences in application. |

Refer to the issues identified above in Questions 11 and 12.

In addition to the issues identified above, there is a risk that entities are not applying the requirements of principal versus agent appropriately to achieve a desired outcome. There are a number of arrangements which require the recipient entity to administer grants and/or loan programs where the principal versus agent concept is applicable. Under the current accounting standards (identification of sufficiently specific performance obligations as defined under AASB 15, and AASB 1058) there is a very strong incentive for those organisations that are required (depending on interpretations by preparers and auditors) to adopt up-front revenue/income recognition to want to avoid mismatched recognition by arguing they are an agent.

[1] However, a question arises as to whether the endowment income should be recognised under AASB 15 or AASB 1058. Refer to comments under Topic 1 regarding identification of SSPOs.

In practice, one jurisdiction found that more issues and challenges arose when determining whether funding received is controlled or administered rather than whether an entity is principal or agent. Examples of where this jurisdiction considered whether an item is controlled or administered include:

- whether appropriations that are paid to a department which then provides grants to other agencies in their administrative cluster are controlled or administered by the department. In this jurisdiction appropriations are appropriated to a Minister for the services of a principal department which then pays grants to other agencies within their cluster. Ministers have the ability to re-allocate appropriated funding within the cluster. Therefore, appropriations to each cluster are recognised as controlled items by principal departments. This is because the principal department has the right to direct the use of the funding by determining the identity of beneficiaries, and the amount and timing of payments
- whether appropriations provided to a department for the purpose of the National Disability Insurance Scheme are controlled or are administered transfer payments. The payments were recognised as transfer payments as the identity of the beneficiary (NDIA) and amounts to be transferred to them are determined by the NDIS Act and the Bilateral agreement with the Commonwealth
- determining whether specific grants programs are controlled or administered.

| **Question 14** |
| --- |
| Is there any guidance that would help you determine whether an NFP entity is a principal or an agent? If so, please provide details of the guidance and explain why you think it would be useful. |

<u>Funding for grant and loan programs</u>

While the guidance in AASB 15 is useful in determining principal versus agent it is very private sector focused. For NFP entities, one of the key transactions that entities need to consider principal versus agent (or controlled versus administered) is in relation to the provision of funding for grants and loan programs rather than providing goods or services. ACAG believe it would be useful if the AASB provided considerations and guidance for not-for-profit entities when determining whether the entity is principal or agent and controlled versus administered for these types of transactions.

Some jurisdictions also believe examples should be included for the administration of grants and loan programs, where the grant administrator has to undertake tasks such as marketing, and selection of appropriate recipients. These jurisdictions believe that the grant administering entity that exercises discretion in the selection of appropriate grant recipients acts as a principal and should recognise the grant income/revenue and grant expenses in its P&L. Further AASB guidance would be required on whether the grant income/revenue should be recognised under AASB 15 (i.e. whether the grant administration activities represent a service) or AASB 1058.

<u>Example 3A of AASB 1058</u>

The majority of ACAG jurisdictions believe that illustrative example 3A should be updated to be consistent with accounting standards, that there is only a financial liability after the suitable student is selected and agrees to any scholarship terms.

The example should also be updated to consider the principal versus agent requirements for the scholarship to illustrate whether funds received should be recognised on a gross or net basis in the P&L. It would also be useful if the example considered the outcomes when the university has discretion to determine the scholarship recipient compared to the outcomes when it does not.

## Topic 5: Grants received in arrears

| Questions 15 and 16 |
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| Do you have any comments regarding:<br>15. the accounting for grants received in arrears, particularly where some of the work to be funded by the grant is performed before the funding is received? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful<br>16. whether differences in application exist in the accounting for grants received in arrears exists? If so, please provide examples that illustrate the relevant circumstances, their significance and the prevalence of any differences in practice. |

ACAG believes the AASB need to clarify the accounting for grants in arrears accounted for under AASB 1058. The below sets out the various views and current practices adopted in different jurisdictions.

Application of contract assets

AASB 1058 does not contain the concept of a 'contract asset' (which is only a concept in AASB 15). Therefore, under AASB 1058, for a grant received in arrears, an asset can only be recognised if the requirements for a receivable asset (under AASB 9 and AASB 15.108) are met. i.e. there is an unconditional right to receive the cash (subject only to the passage of time). However, there are views in some jurisdictions that for capital grants, because of AASB 1058 paragraph B16 linking to AASB 15, that a contract asset can be recognised for payments in arrears.

Requirements of AASB 1058

Under AASB 1058 (i.e. where AASB 15 is not applicable), income (or any related amounts) can be recognised if the entity has an asset e.g. a financial asset (that is, cash has been received, or the entity has a receivable). A receivable can only be recognised in accordance with AASB 9 when the entity has a contractual right to receive cash or another financial asset from the grantor. Therefore, an important factor is that the entity has met the agreed milestones for billing under the agreement (that is, the only remaining condition is the passage of time).

Practical application issues arise when it comes to determining what is necessary with regards to the entity 'assessing that it has satisfied the eligibility criteria of the grant agreement' and 'the NFP expects the claim to be accepted by the grantor' (terminology used in the staff FAQ) and whether the grantor has little, if any discretion to avoid the payment.

There are often diverse views on whether an approval and verification process is purely administrative, meaning the receivable is unconditional.

In most cases, when submitting a claim, an entity would argue that they are expecting that claim to be accepted, particularly given the certifications often required. However, in practice, these claims are often heavily scrutinised, and may be based on subjective criteria of which there are different opinions. As such, in many cases, particularly funding from the Commonwealth, some jurisdictions have the view that the income (and receivable) should not be recognised until the claim has been accepted (for example funding programs in which the Commonwealth agrees to reimburse State for certain expenditure such as Disaster Recovery Payments). It is also unlikely that a payment schedule in a National Partnership or State Partnership Program will constitute a receivable. A more specific confirmation from the Commonwealth of payment timing and amount would be required.

Staff FAQ example of grants in arrears

AASB 1058 and the FAQs do not clarify whether an asset can arise prior to the definition of a financial asset being met. While the FAQ states that a contract asset should not be recognised based on the facts and circumstances of the example provided, that is because there are no further conditions to be met. No example is actually provided where there are still conditions outstanding.

Scenario 1a:

- One jurisdiction believes that the fact pattern in Scenario 1a is not sufficiently detailed. For example, the jurisdiction agrees that unbilled work-in-progress can be recognised, and the associated income, as at 30 June 202X because of the contract details (permitting billing at the end of the quarter, that is, 30 June 202X). They believe that at (say) 31 May 202X, the entity (which is not applying AASB 15) would not be able to recognise any asset, as it does not have a right to bill until 30 June 202X. Similarly, if the right to bill was after 30 June 202X (for example at 31 July 202X), then the entity would not have a right to bill as at 30 June 202X and no income would be recognised at 30 June 202X. This jurisdiction agrees that on the original facts an equivalent contract asset (and income) should be recognised at 30 June 202X, however, it does not believe that a financial asset could be recognised as the amount has not yet been billed.
- Another jurisdiction is of the opposite view that a contract asset should not be recognised as the concept of a contract asset does not exist in AASB 1058. Instead, a receivable should be recognised as the entity has the right to bill at 30 June 202X. Even though the entity has not yet billed at 30 June 202X, the billing process is a mere administrative formality. If, under alternative facts, the entity did not have the right to bill at 30 June 202X, no receivable and no income would be recognised.
- At least three other jurisdictions believe that the FAQ is not clear as to how the definition of receivable is met at 30 June 202X because the entity only expects the claim to be accepted by the grantor, it does not have an unconditional right to bill the grant money until after the end of the financial year. These jurisdictions also then contemplate whether this is sufficient to recognise a revenue accrual under AASB 9 because there are no other milestones which need to be met? One of these jurisdiction also considers that another view is that a contract asset could be accrued every month.

Due to the divergent views above, ACAG recommends the AASB revisit the staff FAQs and clarify whether income should be recognised when the work is performed, the claim is raised, or when the claim is approved.

In relation to Scenario 1b, while based on the interpretation of the facts and circumstances there are no further conditions (other than the passage of time), some jurisdictions think the example needs to further clarify how the definition of a financial asset has been met. This is because while the payment may not be received until the end of the quarter, the entity is entitled to bill at the end of each quarter. Additionally, the current wording remains unclear about the existence and nature of any milestones which may be indicative of conditions which must be met prior to the definition of a financial asset being met. If the AASB are of the view that it depends on the nature of the milestone (that is, the timing of billing only or is it a stage of completion type milestone) then more examples or clarification should be provided, including whether this would warrant the recognition of the equivalent of a 'contract asset'.

ACAG believes that the ability to recognise a contract asset should be clarified for grants in arrears, particularly where the grant meets the conditions in paragraph 15 of AASB 1058.

Examples in ITC

One jurisdiction disagrees with the conclusion on the example of holding community engagement sessions within the ITC as they believe that a sufficiently specific performance obligation exists – that is, to hold community engagement sessions. While the grantor may not have included details such as location and target audience, the recipient is permitted to decide how those sessions are held, and is entitled to $100 for each session. Consequently, the recipient should be able to recognise revenue as it performs the performance obligation (that is over time), and not when the amount is billed at six-monthly intervals.

The jurisdiction notes that if the recipient was a private sector organisation, there would not be as much focus on the term ‘sufficiently specific’. Instead, the focus would be on the performance obligation (to hold community engagement sessions), and whether there is a suitable measure for performance (which there is).

Jurisdictions' examples of grants in arrears

Jurisdictions encountered grants in arrears in a variety of different situations. Examples of these are included below.

One jurisdiction encountered the following situations for grants in arrears:

- funding after the related expenditure has been made, for arrangements for specific projects or activities, or eligible / allowable expenditure – where there is no sufficiently specific performance obligation under AASB 15. Income was recognised when an invoice was issued
- funding after the related expenditure has been made, for arrangements for specific projects or activities, or eligible / allowable expenditure – where there is a sufficiently specific performance obligation under AASB 15. Revenue was recognised as expenditure is incurred, that is, on a percentage of completion basis
- capital expenditure, for example when the project is only partially completed (or a specific date), and also when the project is complete. Income was recognised because of the provisions of AASB 1058 that link to AASB 15 to determine the amount of income to be recognised (percentage complete) of the performance obligation to build the asset.

Another jurisdiction encountered the following situations for grants in arrears:

- Disaster recovery payment. The jurisdiction agreed that for disaster recovery payments related to activities that did not contain sufficiently specific performance obligations, a receivable should only be recognised when the claim has been approved
- Roads to Recovery program - the same principles applied for a receivable from the Commonwealth under the Roads to Recovery program (accounted for under ASSB 1058 as there are no sufficiently specific performance obligations and it did not meet the criteria for capital grant accounting). The entities should only recognise a receivable when they had met all of the required conditions, submitted a quarterly report and the payment had been approved
- Grant monies from a special deposits account – the jurisdiction assessed that a receivable could not be recognised by an agency for funding received from a Special Deposits Account as there was no enforceable agreement / funding deed in place and therefore no unconditional right to receive the payments.

## Topic 6: Termination for convenience clauses

| **Question 17 and 18** |
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| Regarding accounting for termination for convenience clauses:<br>17. do you support view (a) or view (b) regarding recognising a liability in relation to unspent funds? Please explain your rationale, including references to Australian Accounting Standards. Examples to illustrate your responses are also most helpful;<br>18. do you have any other comments? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful. |

Approach for accounting for termination for convenience clauses (TFCC)

All ACAG jurisdictions except one jurisdiction (that sees merit in both arguments) support view (b) for the reasons outlined in the ITC. The jurisdictions supporting view (b) do not support view (a) as:

- the requirements for a financial instrument are not met as the there is no party that recognises a financial asset. We understand that the grantors of arrangements with termination for convenience clauses are not currently recognising the corresponding financial asset to the financial liability in their financial statements which raises the question of whether there is a financial liability

- it does not represent the substance of the agreement. Paragraph 15 of AASB132 states, “The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the **substance of the contractual arrangement** and the definitions of a financial liability, a financial asset and an equity instrument” [Emphasis added].The substance of most of the funding arrangements is non-financial in nature, i.e. requiring the recipient entity to fulfil obligations under the funding arrangements rather than requiring them to repay the funds granted. These clauses are protective in nature so as to provide flexibility to the government where required and are rarely exercised in government
- this view could be argued for any enforceable grant which requires spending the money on eligible activities or repaying any unspent amount – which we do not believe was the intention of the AASB.

The recognition of a financial liability when a grant is received due to the existence of a TFCC would represent a significant change in practice. It is very common for TFCC clauses to be included in government contracts, particularly with the Commonwealth. As of 1 January 2016, all non-corporate Commonwealth entities (NCEs) must use the standard terms in the Commonwealth Contracting Suite (CCS) for contracts for goods and service valued up to $200,000 (GST inclusive), with some exceptions. The CCS Commonwealth Contract Terms include a termination for convenience clause. This clause provides a bilateral right for either the Commonwealth or the supplier to terminate the contract at any time by providing notice.

In another jurisdiction, an auditee received a grant recognised under AASB 1058 as it did not meet the criteria to be recognised under AASB 15. The auditee received advice from a consultant that they should recognise a financial liability for a TFCC included in a grant agreement. On reviewing the agreement, the jurisdiction noted that while there was a clause for termination or reduction in scope there was no specific requirement which required the actual repayment of funding. The clause allowed the grantor to request the payment but did not specifically require it.

ACAG therefore recommends the AASB determine an appropriate action and make this clear in the standards. Providing clear guidance will help reduce diversity in accounting for these clauses.

<u>Other comments on TFCC</u>

AASB staff presented a staff paper ‘5.1 Termination for Convenience Clauses – Staff analysis’ at the November 2020 AASB Board meeting. The Staff paper considers different views as to whether a termination for convenience clause (TFCC) gives rise to a financial liability:

- View 1 – at inception of a contract (View 1), or
- View 2 – not until there is a request for repayment (View 2).

In this paper, the staff concluded ‘that the requirements of Australian Accounting Standards and available guidance provide an adequate basis to enable an entity to account for termination for convenience clauses and to address the alternative views expressed by the submitters.’ However, it is not clear which, or both, views they think is correct.

The majority of ACAG jurisdictions believe the following issues should be considered when determining the approach for TFCC that do not appear to be considered in the staff paper:

- the underlying issue of the timing of the obligation. Instead, the discussion appears to assume that the TFCC is part of a financial instrument and then discusses whether the clause has ‘substance’
- the implications of accounting for the TFCC financial asset held by the grantor
- implications of recognising a TFCC as a financial liability on revenue recognition. Specifically, recognising TFCCs as a financial liability means that revenue will not be subsequently recognised as the grant activities are undertaken. That is because financial instruments are excluded from the scope of AASB 15 and accounted for under AASB 9. Instead, there would be some sort of gain from the reduction in the financial liability (of the amount repayable under the TFCC), as activities are undertaken. Similarly, under AASB 1058 there would be no income from the grant, but a gain from reduction in the financial liability. One jurisdiction understands

that those adopting this view in the private sector are not recognising the reduction of the financial liability as some sort of extinguishment under AASB 9, but as revenue from goods and services etc.

- the implications for other grant agreements that have a contractual obligation to pay cash. The basis for classifying a TFCC as a financial liability appears to be based on the view that there is a contractual obligation to pay cash. If TFCCs are considered financial liabilities, there is an argument that many grant agreements without a TFCC that have a contractual obligation to pay cash would also be a financial liability. For example, if the agreement requires expenditure on eligible activities or the grant must be refunded. The transfer recipient would have a financial liability because it has a contractual obligation (under the binding arrangement) to pay the cash received in the delivery for the specified activity or return the unspent cash to the transfer provider (or incur another form of redress.)

ACAG notes that the following IFRIC agenda decisions were discussed in the staff paper and other technical discussions on whether TFCC gives rise to a financial liability:

- A financial instrument that is mandatorily convertible into a variable number of shares (subject to a cap and a floor) but gives the issuer the option to settle by delivering the maximum (fixed) number of shares (IAS 32) (January 2014)
- Accounting for Government Grants and Disclosure of Government Assistance – Accounting for repayable cash receipts (IAS 20) (May 2016)
- Classification of liability for a prepaid card in the issuer's financial statements (IAS 32) (March 2016)'

Most ACAG jurisdictions have concerns that some of the IFRIC agenda decisions have been taken out of context. For example, the IFRIC Agenda decision in January 2014. This issue discussed the substance of clauses in a financial instrument. It is important to note that the instrument was classified as a financial instrument and the discussion was in relation to the clauses and settlement options in that financial instrument. The discussion was not around whether a clause (such as a termination for convenience clause) was a financial instrument. The substance of the transaction in the agenda decision is different to grant income, which requires the recipient entity to fulfil obligations under the funding arrangements rather than requiring them to repay the funds granted. Further details can be provided to the AASB if required.

## Topic 7: Accounting for research grants

| **Question 19** |
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| Do you have any comments regarding the accounting for research grants (other than termination for convenience clauses, which are covered in Topic 6)?<br><br>If so, please provide your views on the requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful. |

Costs versus benefits and difficulties in accounting for research grants

There is a significant amount of time and effort that goes into reviewing the numerous research contracts with many of them being complex. There is also significant judgement required to determine what the goods or services being provided actually are and how those are transferred. Some jurisdictions have found that:

- some of these agreements are extremely complex in determining who has what rights. In the illustrative examples, it is clear that one party has a greater right/benefit than the other but in practice, many rights are shared
- a lot of the agreements were extremely specific, outlining the hypothesis the research was to prove or disprove, designating the timeframes for the delivery of stages of the research and often naming the researchers who would conduct or lead the research with continuous open access clauses. There were others that were less specific that referred to knowledge sharing that were recognised under AASB 1058

- the costs of research can be incurred over a lengthy period of time albeit there may not be stages of reporting. In many instances there is some sort of promise for a published research paper. In other instances, the research is not published which presents an issue in relation to revenue recognition.
- there is little, if any, enforcement of any promise of a publication. Specifically, there is no enforcement of a return of funds if there is no publication. The accountability, and enforcement, is primarily focused on the promised research activities.

Notwithstanding the above, ACAG understands that for the majority of universities there is consistency in how the revenue for the main research grants (Australian Research Council (ARC) and National Health and Medical Research Council (NHMRC)) are being recognised under AASB 15. However, the recognition of the ARC and NHMRC grants under AASB 15 by four universities in one jurisdiction differed from the Audit Office position (which is aligned with the views in AASB staff FAQs), which was that there were no SSPOs and that revenue for these agreements should be recognised under AASB 1058. Further information is available at: (https://www.audit.vic.gov.au/report/results-2019-audits-universities).

Purpose of research grants

The majority of ACAG jurisdictions continue to express concerns on the approach taken in the illustrative examples of the research output being the publication. In addition, not all research is undertaking experiments – for example research in the humanities.

We have highlighted below extracts of our concerns in the ACAG letter to Kala Kandiah on the 28 August 2019 (although at least one jurisdiction is in support of the AASB staff FAQs and is of the view that that ‘undertaking research activities’ are not performance obligations. This is because undertaking research activities do not themselves provide benefits, unless outcomes from the research are obtained and made available (shared) with the grantor (and third-party beneficiaries) (AASB15.F21). Research activities are inputs and processes to achieve outputs and thus are not outputs themselves).

*ACAG understands that based on the work universities have performed so far, that the performance obligation of many research grants can be considered as the undertaking of the research activities which are effectively purchased by the grantor / customer. The staff view appears to be that the only performance obligation, when IP is not being transferred, is the publication of a report.*

*… Using an audit as an analogy, while the output may be considered the audit report (as an analogy to the research publication), it could be argued that the services are not the publication of the audit report, but the audit activities undertaken.*

*Purpose of the research grant*

*When the nature and purpose of government research grants through the Australian Research Council (ARC) and National Health and Medical Research Council (NHMRC) are considered, the desired output is the research activities to be performed – irrespective of traditional indicators of success. Using terminology under AASB 15, the customer (the research councils) can be viewed as entering into the agreement for the grant recipient (often a university) to perform those research activities. To use slightly different terminology, the research councils are purchasing research activities.*

*It appears the focus of the FAQ is premised on the publications from the research activity as the performance obligation rather than the research activity as the performance obligation. While public publication is often expected in research grant agreements, sometimes this does not occur and is not intended to occur as knowledge gained from the research is to be translated to practice in other ways. However, public publication does not determine whether the grant recipient has provided the promised research activities. That determination is achieved by the grant recipient reporting to the research councils on the use of the funds provided against the promised research activities. As long as the research is conducted in accordance with the agreement, the grant recipient is entitled to the funding, regardless of what outcome is reached, or if the grant recipient publicly publishes the findings.*

Recognition of research revenue over time

To recognise a research grant over time, an entity must meet the criteria in paragraphs 35(a), (b) or (c) of AASB 15. If the criteria in 35(a) and (b) are not met, the second element of paragraph (c) requires the entity to have an enforceable right to payment for performance completed to date.

Paragraph 37 states that at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised and refers to paragraphs B9–B13 for additional guidance.

Paragraph B9 states that an amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin). Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

(a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or

(b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

In the public sector research grants are generally designed to cover costs without a profit margin. The majority of ACAG jurisdictions recommend the AASB provide guidance on how the requirements in paragraph B9 should be interpreted where that is the case. The issue of no profit margin also applies to other NFP and public sector arrangements.

The alternative use criteria is also difficult to apply should the criteria in paragraphs 35(a) and (b) of AASB 15 not be met. It is not clear how far you are expected to look to determine whether there is an alternative use, and whether the use has to be economically viable given public sector objectives may not be financially driven.

Contract cost assets for research grants

One area that a jurisdiction has considered is whether the costs to fulfil research contracts for point in time contracts can be capitalised under AASB 15. This has been an area of contention within the jurisdiction due to the apparent circularity of how costs to fulfil research contracts should be treated between AASB 15 and AASB 138. As AASB 138 specifically prevents research costs from being capitalised, the issue is whether costs incurred by a university under a contract with a donor to deliver research (and within the scope of AASB 15), should be captured by AASB 15, given that future economic benefits will flow to the entity.

There are currently two views:

1. Capitalising costs is not appropriate based on the IFRIC Interpretations Committee (the Committee) which issued the agenda decision Training Costs to Fulfil a Contract (IFRS 15 Revenue from Contracts with Customers). Paragraphs 91-104 of AASB 15 only apply when the treatment of costs associated with a contract is not specified by another Standard. Research costs are within the scope of AASB 138 'Intangible Assets' paragraphs 54 to 58. Paragraph 54 states 'No intangible assets arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred'.

   AASB 138 deals specifically with research and development costs. AASB 138 requires research costs to be expensed, and development costs to be capitalised. Neither of these costs, nor any other expenditure that qualifies for treatment under another standard (such as property, plant and equipment under AASB 116) should be considered for capitalisation in accordance with paragraphs 91 to 104 of AASB 15 as a contract cost.

2. Costs can be capitalised. Paragraph 3(i) of AASB 138 excludes 'assets arising from customer contracts in accordance with AASB 15'. This recognises the distinction between internal research projects and research activities conducted for customers under contract.

This jurisdiction requests clarification from the AASB on which view is appropriate under the current standards.

## Topic 8: Statutory receivables

| **Questions 20 and 21** |
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| Do you have any comments regarding:<br>20. the subsequent accounting treatment of statutory receivables? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful;<br>21. whether the initial measurement of statutory receivables in accordance with AASB 9 added considerably to the workload of preparers and auditors – either on implementation of Appendix C to AASB 9 or subsequently? If so, please provide your views on the initial measurement requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful. |

Subsequent accounting treatment of statutory receivables

The requirements of AASB 9 'Financial Instruments' only apply to the initial measurement of statutory receivables. As a result, entities need to determine the appropriate accounting policies for subsequent measurement of statutory receivables such as applying the impairment requirements in AASB 9 or AASB 136 'Impairment of assets'. This approach permits differences across entities in the subsequent measurement of these assets which may reduce comparability. For example, AASB 136 does not require impairment unless there is an 'impairment indicator' which is likely to result in a later recognition of the impairment expense than under AASB 9. One Treasury department within a jurisdiction mandated the application of AASB 9 to assess the impairment of statutory receivables.

ACAG therefore believes it would be beneficial if the AASB clarifies and provides guidance on the requirements for the subsequent measurement of statutory receivables.

Some jurisdictions found it difficult in practice to measure the expected credit losses (ECLs) of statutory receivables. For example, one jurisdiction had difficulties in measuring the ECL for COVID-19 loans (including issuing a qualification on lack of available information), although this difficulty would have likely arisen for any impairment approach applied. The lack of information included the probability of default, and likely loss given default.

In one jurisdiction, impairment for the majority of statutory receivables is not material and therefore approaches other than the use of a provision matrix under AASB 9 would result in the costs outweighing the benefits.

Initial measurement of statutory receivables

Generally, jurisdictions found that the initial measurement of statutory receivables did not result in considerably more work and that the application of AASB 9 resulted in a more appropriate outcome.

In practice, one jurisdiction noted that there was more work in local government on the initial measurement of statutory receivables because of the need to work out pre-paid rates / rates in advance rather than use a cash basis.

This jurisdiction also identified that there was more work required for developer contributions. Developer contributions may be paid in cash or non-cash consideration. A significant implementation issue related to multi-stage property developments. For example, for a 100 property development, built in stages, when the first 10 properties are sealed, under the law it is only the infrastructure charges on those 10 properties that are due and payable at that time. However, in practice, the property developer will often transfer non-cash consideration (PPE) to a value in excess of the 10 properties, and will receive 'infrastructure credits' or 'infrastructure offsets' that can be used to offset

later charges (for example the infrastructure charges on the next 20 properties). This jurisdiction noted that prior to the changes for statutory receivables, there was a lot of diversity on how these infrastructure charges, and infrastructure credits, were accounted for and that the NFP changes resulted in more consistency. However, under the AASB 9 NFP change, it is only the statutory charge (for example, for the 10 sealed properties above) that is due and payable under the law – not the fair value of the PPE received. As a result, councils need to do more work to work out pre-paid charges (and the associated infrastructure offsets).

Further guidance from the AASB on the above matter may be useful. For example, while recognising deferred income in the above circumstance means only the amount that is statutorily due is recognised as income, if the developer decided not to proceed to the next stage of development then it becomes unclear how the deferred income can be brought to account. The ability to bring this income to account becomes more unclear where the developer may plan to use those offset credits for unrelated project(s) that never come to fruition because the developer exits the market, becomes bankrupt etc.

<u>Disclosure of statutory receivables</u>

While AASB 9 considers the initial recognition of statutory receivables, it is not necessarily clear whether these receivables are within the scope of AASB 7 for disclosure purposes. Some jurisdictions have seen differences in practice. For example, the exclusion of GST receivables from AASB 7 disclosures, but the inclusion of rates receivables.

## AASB General Matters for Comment

| **Question 22** |
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| Does the application of AASB 1058 and AASB 15 by NFP entities adversely affect any regulatory requirements for NFP entities? |

ACAG is not aware the application of AASB 1058 and AASB 15 by NFP entities adversely affecting any regulatory requirements.

| **Question 23** |
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| Does the application of AASB 1058 and AASB 15 by NFP entities result in major auditing or assurance challenges? |

Yes, the major auditing or assurance challenges include those areas where there is significant amount of judgement and those where there is a lack of guidance. Those that have been discussed above include:

- determining whether there are ‘sufficiently specific’ performance obligations (Questions 1-4)
- application of the term ‘identified specifications’ (Questions 5-8)
- determining whether an entity is principal or acting as an agent (Questions 11-14)
- determining when a receivable can be recognised for grants received in arrears (Questions 15-16)
- accounting for termination for convenience clauses (Questions 17-18)
- accounting for research grants (Question 19).

| **Question 24** |
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| Overall, do AASB 1058 and AASB 15 result in financial statements that are more useful to users of NFP entity financial statements? |

ACAG believes that there is scope to increase the consistency in accounting for income of not-for-profit entities by providing additional guidance in the key areas we have mentioned.

ACAG understands many preparers with mis-matched revenue and expense recognition believe that having better “matching” would result in more useful financial statements.

| **Question 25** |
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| In your view, do the benefits of applying the requirements of AASB 1058 and AASB 15 exceed the implementation and ongoing application costs for NFP entities? |

ACAG is not able to comment generally on the costs and benefits of the proposals.

ACAG believes that if the AASB clarifies the issues above, and provides more guidance where relevant, this will help reduce the costs of applying AASB 15 and AASB 1058.

We understand many preparers with mis-matched revenue and expense recognition believe that having better “matching” would result in reduced costs by better linking to the acquittals process.

| **Question 26** |
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| Are there any other matters that should be brought to the attention of the AASB as it undertakes this PIR on the accounting for income of NFP entities? |

Contracts to provide goods or services

Some jurisdictions have found in practice that people are missing the fact that to be within the scope of AASB 15 the contract/agreement needs to require provision of goods and services (not cash). It would be useful if this is made clear in Appendix F of AASB 15. Currently this is only clarified in one example in AASB 1058.

There are also differences in opinion amongst jurisdictions on the recognition of revenue for Commonwealth grants caused by the 'contract with a customer to provide goods and services criteria'.

In one jurisdiction, the accounting for Commonwealth grants is accounted for depending on whether or not the Commonwealth has the Constitutional Power to make laws over the related services. Where this is not the case, and funding has been received as section 96 financial assistance to the State, the jurisdiction concluded that the Commonwealth is not the customer of the State.

The Commonwealth’s powers are specified in the Commonwealth of Australia Constitution Act. The main grants for which there is divergent practice occurring as a result of this review is the accounting for Activity Based Health Funding. At least two jurisdictions (including the jurisdiction specified above account for this funding under AASB 1058, whereas at least two other jurisdictions account for the funding under AASB 15 as they are considered to be providing services where there are sufficiently specific performance obligations.

The IPSASB approach may address this issue (at least resulting in the same treatment, acknowledging that there may still be differences of opinion about whether ED 70 or ED 71 applies).

Recognition of volunteer services

Under AASB 1058 volunteer services are only recognised if the NFP entity would have purchased the services if they were not donated. In one jurisdiction, we found practical challenges in determining whether the services would have been purchased. For example, some agencies:

- suggested they would provide the service, but at a reduced capacity or would provide the service in a different way, for example, disaster response
- pointed to being reliant on government funding and that this would limit their ability to ‘otherwise purchase’.

It is unclear how delivering the service via a different way impacts on the recognition of volunteer services. Obtaining evidence to support the above assertions is also challenging.

It would be useful if the AASB considered the above challenges and provided additional guidance for whether volunteer services should be recognised in these circumstances.