AUSTRALASIAN COUNCIL OF AUDITORS GENERAL

31 March 2023

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Dr Kendall

AASB Invitation to Comment ITC 50 *Post-implementation Review –*

Income of Not-for-Profit Entities

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on AASB Invitation to Comment ITC 50 *Post-implementation Review – Income of Not-for-Profit Entities*. The views expressed in this submission represent those of all Australian members of ACAG, unless otherwise specified.

ACAG supports the Board's efforts to seek stakeholders' feedback about their implementation experience of AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities* for not-for-profit entities.

In this letter, ACAG has raised numerous accounting and application issues, and auditing or assurance issues. The disparity of views and judgements on some areas were not only across the ACAG network but also arose from our audit experience where divergent interpretations were reached by consultants used by the entities we audit. While ACAG has tried to provide a summary of the implementation experience of various jurisdictions, supported by examples where relevant, ACAG offices will be happy to engage directly with the AASB staff, should they need more information on any of the aspects covered in the letter.

ACAG has also included other suggestions and recommendations that we believe will help promote greater consistency and comparability of application across the public sector.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the ITC.

ACAG appreciates the opportunity to comment and trusts you find the attached comments useful.

Yours sincerely

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Chair
ACAG Financial Reporting and Accounting Committee

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Attachment

AASB Specific Matters for Comment

Topic 1: Sufficiently specific criterion and the legal interpretation of agreements

Questions 1, 2 and 3
Regarding the term sufficiently specific in AASB 15 Appendix F, do you have any comments about: 1. the application of the term in practice? 2. the extent of specificity needed to meet the sufficiently specific criterion for a contract (or part of a contract) to be within the scope of AASB 15? 3. whether differences in application exist? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

Application of 'sufficiently specific'

The term 'sufficiently specific' is highly judgmental. Assessment of the criteria can be time consuming and often results in different conclusions being reached for the same agreement. The lack of clarity also makes it challenging to resolve differences in opinion.

It is highly uncommon for grants to be provided (outside of general appropriation/operating grants) that do not specify the broad purpose for which the funds must be used. However, jurisdictions have found the terms and level of detail to differ – ranging from specifying the broad outcomes/objectives to be achieved, to detailed deliverables. The example scenarios included in the ITC helps explain the diversity of views in determining exactly what level of detail is necessary to meet the sufficiently specific performance obligation (SSPO) criteria.

Paragraph F22 of AASB 1058 specifies that no specific number or combination of the conditions in paragraph F20 need to be met for a promise to be sufficiently specific. However, based on the implementation examples and the guidance in paragraphs F20 to F26, the bar for assessing if a promise is sufficiently specific appears to be high.

Jurisdictions have encountered many instances where the auditor's and preparer's view of what is sufficiently specific differs. The conclusion on whether there are sufficiently specific performance obligations is critical given the implications when used with the current model in AASB 15 (of a performance obligation to provide goods and services) to determine the amount of revenue to be recognised. ACAG believes if the revenue model is changed (refer below to question 10), then reliance on the term 'sufficiently specific', and the diversity arising from various interpretations could potentially be reduced.

Conclusions drawn under AASB 15 about sufficient specificity are not always consistent with the reporting or acquittal provisions in grants. Jurisdictions found that, for most or almost all arrangements where there is a potential refund obligation, the funding arrangements required the funds to be spent on specific projects or activities, or eligible / allowable expenditure. However, these obligations often do not match the AASB 15 'performance obligation' to provide goods or services, and consequently the 'sufficiently specific' requirements of AASB 15 (to determine the extent of performance in fulfilling the AASB 15 definition of performance obligation) is a separate process to the funding acquittal process. This makes AASB 15 difficult to apply in practice which has resulted in many preparers, consultants and auditors focusing on the reporting or acquittal provisions in assessing sufficiently specific, when such focus was not relevant if no goods or services were provided (assuming that spending funds received is not a performance obligation). Consequently, time and effort were spent arguing to cross-purposes and different understandings of what the standard requires.

Paragraph F20 clarifies that a necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is sufficiently specific to be able to determine when the obligation is satisfied. In practice this can be a useful consideration in applying judgement about whether the sufficiently specific criteria has been met. Application of this principle itself requires interpretation and judgement. It is not clear how paragraph F20 relates to paragraph F25. It could be argued in many cases that the recipient entity knows how much the goods/services provided to date cost, and as such this meets the criteria. While input methods may be a suitable method of determining revenue recognition, it does not necessarily equate that there is a SSPO. This can be challenging to apply in practice. While paragraph F26 tries to address this, it is unclear how much reliance can be placed on an acquittal process based purely on spending funds received. This is often further exacerbated by the fact that the agreement may include a number of outcomes/deliverables, some of which would appear not to meet the SSPO criteria. It is not always clear how the funding aligns with each of these outcomes/deliverables 'to determine when the obligation is satisfied' (paragraph F20). For example, what is considered to be funding for 'activities required to fulfill the contract' (i.e. setup activities) (paragraph 25) versus provision of a service to a customer which meets the SSPO criteria vs neither a performance obligation nor setup activity?

An associated complexity is when there is a grant application which forms part of the agreement and if that specifies amounts, whether the recipient is tied to spending those amounts on those specific items or not. That is, while that may have formed the overall determination of the total amount provided, does the recipient have the ability to move those funds around within the bounds of the various elements/objectives of the project? Also, would it make a difference if, instead of the entity having discretion on how much to spend on each element, the grant agreement includes a budgeted breakdown of the spend on each element? Would the total grant consideration have to be allocated to each element and accounted for accordingly?

One jurisdiction also found in practice that many preparers are interpreting the term ‘sufficiently specific’ using common English definitions, and not how the term is used in a technical way to apply AASB 15 in determining the ‘percentage of completion’. The jurisdiction believes that if AASB 15 is aligned to common funding arrangements (for example, that include spending obligations on specific projects/activities), then based on how funding arrangements are commonly drafted, all of the ITC50 examples (a) to (h) would likely meet the test for being sufficiently specific to determine compliance with the funding spending obligations.

One jurisdiction noted that paragraph F28 of AASB 15 which states '*A customer may enter into a contract with a NFP entity with a dual purpose of obtaining goods or services and to help the NFP entity achieve its objectives*' is sometimes mis-construed. This paragraph is sometimes used where it is unclear if there is a SSPO to argue that the grant is assisting the provider (where internal to Government) achieve their objectives. It should be clarified that this paragraph is not designed to assist in determining whether a SSPO exists, but how to allocate the transaction price where an element of the money provided is a 'donation'.

<u>Examples of sufficiently specific in the ITC</u>

The examples in the ITC help illustrate the diversity of views in making the judgement as to whether a performance obligation is sufficiently specific.

The jurisdictions agreed with the conclusions in the ITC that scenarios (a) and (b) are not sufficiently specific and (h) is sufficiently specific. There were however different views amongst the jurisdictions on whether the other scenarios (c) to (g) met the ‘sufficiently specific’ criteria as it is not black and white and significant judgement is involved. These views included:

- it could be argued that scenario (c) is sufficiently specific if the entity only provided mental health counselling services to adolescents in Melbourne
- it could be argued that scenario (d) is sufficiently specific. Paragraph F25 implies that specifying the services to be provided and the time period enables a determination of when the services have been provided. So, if the agreement specifies 'counselling services in Melbourne' and 'for the next 24 months', this may be argued to be sufficiently specific, acknowledging that the entity has discretion as to what type of counselling services and to whom. However, it can equally be argued that an element of entity discretion exists even in scenario (h) as the entity could choose between the following options:

- group counselling sessions versus. one-to-one counselling sessions
- online versus physical counselling sessions
- nutrition counselling versus financial awareness counselling.

- AASB 15 is not specific enough to draw a firm conclusion on whether the facts in scenario (f) and (g) suffice to meet the sufficiently specific criteria. Only when the number of sessions and/or number of hours to be provided is specified does it clearly meet the criteria. In determining whether the criteria are met, it is important to consider the amount of discretion which remains with the grantee. The example included in the ITC does not specify what services are provided by the grantee. For example, if the grantee only provides mental health counselling services to adolescents, it may be that the SSPO criteria are met earlier – this is because there may be far less discretion in terms of what it could be spent on. That is, it could not be used to provide other types of counselling to other age groups. Paragraph F25 explains that a single purpose charter is unlikely to be enough – but it could be that the single purpose is more specific than that in the example provided in F25. It is not currently clear.
- none of scenarios (c), (d), (e), (f) and (g) meet the sufficiently specific test under AASB 15 to determine the extent of performance ('percentage complete') as the performance obligation is unknown / not sufficiently specific.

Jurisdiction's examples of 'sufficiently specific'

One jurisdiction has had numerous cases where they had significant discussions around the SSPO criteria including grants in the heath sector, local government grants and research grants. There were discussions on whether providing money to a recipient to employ people to create new jobs for displaced workers due to COVID-19 falls within the scope of AASB 15 or AASB 1058. The jurisdiction concluded that 'the obligation to provide employment and make salary payments to displaced workers does not appear to meet the definition of a performance obligation as AASB 15 requires transfer of 'distinct' goods and services. Handing over cash is not considered to be a performance obligation under AASB 15. This interpretation is in line with Example 3A of AASB 1058 that states, "In this example, no transfer of specific goods or services is required under the terms of the endowment. The scholarship is paid in cash rather than through the provision of goods or services. Accordingly, the university determines that it does not have a contract with a customer (the alumnus) that would be accounted for in accordance with AASB 15." Furthermore, the monies received will help the recipient achieve its broader objectives and it is able to utilise the money at its own discretion on several projects related to community services.

Question 4
In addition to the existing guidance in AASB 15 Appendix F, is there any other guidance that would help you determine whether a contract (or part of a contract) is sufficiently specific? If so, please provide details of the guidance and explain why you think it would be useful.

Some of the jurisdictions have suggested including the following additional guidance and examples:

- separate guidance/examples in relation to goods versus services. There are often concepts which apply well to one, but not the other. For example, – quantity – for goods, the quantity may need to be specified for it to meet the SSPO criteria, but for a service, such as 'mental health counselling services for adolescents' some believe this may suffice. However, others believe 'mental health counselling services for adolescents' is not sufficiently specific, as only $1 needs to be spent under that description (without necessarily providing any goods or services), when it is usually clear in funding agreements that the entire amount must be spent on those activities.

  Some jurisdictions think the application to services is more difficult in practice. For example, determining whether a contract specifies the services an entity promises to transfer to a 'customer'. In a public sector context, everything the government does should be to meet their objectives which are service delivery for the benefit of the broader public. So, at what point does a service move from 'consideration to enable a NFP public sector entity to further its objectives' to a performance obligation to provide goods or services (with the customer being the grant provider and the provision of goods or services to the public being a characteristic of that promise to transfer goods and services to the customer)? This makes it extremely difficult to

determine what principles should be applied where the level of specificity required involves such a high degree of judgement

- paragraph F22 of Appendix F states that 'there may be other conditions that need to be taken into account in applying the judgement above (in addition to conditions specified in paragraph F20 (a) to (d)) that may indicate the promise is sufficiently specific'. It would be useful for the AASB to provide further clarity or example(s) of such other conditions
- additional guidance or examples on a range of funding arrangements, particularly agreements with government entities for service delivery and agreements relating to research reports, and specify what wouldn't be 'sufficiently specific'
- more examples that consider the substance of arrangements including other facts and circumstances and implied promises so that stakeholders can understand how to identify a SSPO when the agreements are not clear. For example, in the case of the ITC example, where the SSPO determination is unclear, instead of stating that it is a matter of judgement, the AASB could provide a few scenarios and advise which scenarios have SSPOs
- an example when there is more than one funding source for the SSPO (e.g. one or more grants as well as the entity's own funds and how to allocate specific grant funding to the SSPO. Is it the entity's choice as to which source it applies first, second, etc., or should an average percentage of completion be used across all sources? Alternatively, is this inability to determine when the obligation is satisfied, result in all the grants being accounted for under AASB 1058?

Topic 2: Capital grants

Questions 5, 6 and 7
Regarding the term identified specifications in AASB 1058 paragraph 15(a), do you have any comments about: 5. the application of the term in practice? 4. the extent of specificity needed for a contract to meet the requirements of AASB 1058 paragraph 15(a)? 5. whether differences in application exist because of the use of the term identified specifications? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

Determining whether the 'identified specifications' criterion is met is subject to interpretation and a significant amount of judgement as 'identified specifications' is not currently defined in AASB 1058 and there are only two examples provided on how to apply this concept in practice. Differences in application are likely to arise given the judgement involved in determining how specific the requirements need to be in relation to the size, composition or location of the asset to meet the 'identified specifications' criterion. For example, one jurisdiction has had the occasional misinterpretation of 'identified specifications' due to the application of 'identified specifications' being applied using a common English meaning rather than the technical application of AASB 1058.

The term 'identified specifications' implies a high degree of specification – such as architectural designs. However Illustrative Example 9 in AASB 1058 clarifies that specifying that a building must meet the standards specified by regulation (and includes a set number of rooms) is enough.

In practice, some jurisdictions found that:

- grants are generally specific about what must be built (that is, the purpose of the building or the asset). However, judgement must still be applied. For example, if the funding is to build a performing arts theatre at a school which provides a 500 person capacity – we assume this meets the criteria. However, is the 'identified specifications' criterion met if less detail is provided such as funds to build a performing arts theatre at a particular school? While the capacity is not specified, the school's maximum enrolment capacity is known, and it is reasonable to assume that the theatre appropriately caters for that number of students

- funds received are almost always for building assets on State-owned land, so that assists in concluding that the control criteria are met.

One jurisdiction has applied the term 'identified specifications' in the context of being able to identify how the funds are being acquitted against the obligation to build the asset. This jurisdiction found that the acquittal provisions in funding arrangements, and usually the associated budgeting and planning approvals, are sufficient to be able to understand what asset is being built.

The above jurisdiction found the capital grants examples in the ITC, simplistic and unrealistic. In practice, the jurisdiction found that where funding / capital grants are given, and there is an obligation on the recipient to spend that money on the construction of an asset under an enforceable agreement, the arrangements have provisions for the acquittal of those funds – details on what asset is being constructed. Therefore, an obligation is identified, and the 'percentage complete' can be determined.

Some of the complexities the jurisdictions encountered in practice include whether:

- the liability (funds received in advance) and asset (unbilled work-in-progress) should be included in the AASB 15 contract asset / liability disclosures, given the link from AASB 1058 to AASB 15 for revenue recognition. In practice some jurisdictions (but not all) include the liability under AASB 1058 in the disclosures for contract liability disclosures under AASB 15 with descriptions to differentiate contract liabilities and liabilities under AASB 1058
- a grant for the development of inventories to identified specifications (for example, land under development for future sale) can also be in the scope of capital grants under AASB 1058. Refer to question 8 below for further details.

Question 8
In addition to the existing illustrative examples in AASB 1058, is there any other guidance that would help you determine when to recognise revenue following the transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity? If so, please provide details of the guidance and explain why you think it would be useful

Some ACAG jurisdictions believe that additional guidance in the following areas would help determine when to recognise income following the transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity.

<u>Identified specifications</u>

To help users and reduce inconsistencies in applying 'identified specifications', it would be useful if AASB provides some guidance and examples in this regard to address some of the challenges as mentioned above.

<u>Application of capital grants to land under development for a future sale</u>

As mentioned above, some jurisdictions believe that the AASB should clarify that a grant for the development of inventories to identified specifications (for example, land under development for future sale) can also be within the scope of capital grants under AASB 1058 in order to get income recognition on a percentage of completion basis. This is because the development cost of such long-term inventories will be recognised as a non-financial asset for its own use by the entity. The 'for its own use' requirement in paragraph B15 of AASB 1058 does not disqualify the inventories as:

- the 'recognisable non-financial asset for its own use' terminology was included in AASB 1058 in order to distinguish acquired/constructed assets that would be recognised by the entity as opposed to assets that would be used by other parties (and therefore not recognisable by the entity). This is apparent from paragraph B15 of AASB 1058 which states that the 'non-financial asset will be under the control of the entity (that is for its own use) – it will not be transferred to the transferor or other parties'. The entity retains control of the non-financial asset and retains it for its own use as part of its business operations of which inventory is an integral part
- the term 'own use' in accounting literature is not used exclusively in the context of AASB 116 *Property, Plant and Equipment* to describe an item of property, plant and equipment asset held by an entity for its own use. The term 'own use' is also used in the context of AASB 9 *Financial*

Instruments, and previously *AASB 139 Financial Instruments: Recognition and Measurement*) to describe a contract to buy a non-financial item that can be net settled, as if the contract is a financial instrument, but which is outside the scope of AASB 9 if the contract is for the receipt of the non-financial item for the entity's 'own use'. In this case, the non-financial item for own use is typically a commodity (for example, iron ore) used by the entity in its operations as raw material (accounted for under AASB 102 *Inventories*).

Construction of an asset is funded by more than one source

ACAG believe that additional guidance is required in situations where an asset is constructed by using funding from more than one source (for example, one or more grants and the entity's own funds) as it is not clear how the funding should be allocated to the construction of the asset. For example, if there is no indication in the agreement which spending should be spent first, does the entity have discretion as to which source it applies first, second, and so on or should an average percentage of completion be used across all sources?

For example, at the beginning of Year 1, an entity receives two separate grants of $20k and $30k for the construction of a building (to be owned by the entity itself) to identified specifications that will cost $100k. The remainder of the expected cost ($50k) will be funded by the entity from its own funds. At the end of Year 1, construction work in progress is $20k. If there are no specific details in the agreement on which funding should be spend first, should the entity assume that:

- grant 1 is spent first and recognise $20k income; or
- that grant 2 is spent first and recognise $20k income; or
- that each of grants 1 and 2 are only 20% satisfied and therefore recognise $4k and $6k = $10k income.

Does it make a difference whether the obligation under a grant agreement is:

- 'to spend the money on the construction of the building', in which case the full amount of the grant can be recognised as income if it is considered that the grant money has been fully spent in the construction WIP to date (even if the building is only partly complete)?
- 'to spend the money in order to get a complete building (as implied by having milestones, including the final milestone of building practical completion, in the agreement)', in which case income can only be recognised to the extent of the percentage of completion of the building?
- 'to contribute a specific percentage of own source funds versus the entity choosing to provide some of the funding for the project using their own source funds?

Topic 3: Differences between management accounts and statutory accounts and alternative revenue recognition models

Question 9
Do you have any comments regarding the timing of revenue recognition required by AASB 15 and AASB 1058 of NFP entities? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also helpful.

As stated in the ITC, some jurisdictions agree that there is a perception by preparers that the recognition of revenue/income upfront is not useful to some users and is misleading to their financial results. A lot of funding agreements do not have sufficiently specific performance obligations (as defined by AASB 15) which results in the immediate recognition of revenue/income rather than deferral. This accounting outcome does not align with NFP entities' preference for matching revenues/income and expenses.

This has resulted in challenges for management in explaining:

- the different approaches to those charged with governance
- why AASB 15 or AASB 1058 have been applied
- why there may be differences to the operating result between statutory reporting and internal management reporting.

As AASB 15 is not aligned to common funding arrangements in the public sector there are often differences between internal reporting, internal acquittal processes and statutory reporting. There are a variety of ways this is implemented in practice. For example, some jurisdictions have found many entities appear to use upfront revenue/income recognition for management accounting, and then make any adjustments needed for statutory reporting. Some entities will make adjustments monthly (to align management and statutory reporting), and others less frequently, at year end. For many entities, the acquittal process is outside management reporting and statutory reporting.

Question 10
Do you have any views on alternative approaches to recognising revenue in the NFP sector? For example, should an NFP entity initially recognise a liability and recognise revenue: (a) based on a common understanding between the entity and the transfer provider of the manner in which the entity is expected to use the inflows of resources; (b) where there are terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity; (c) on a systematic basis over the periods in which the entity recognises as expenses the related costs for which a grant is intended to compensate; or (d) where the outflows of resources are incurred in accordance with the requirements set out in a binding agreement. If so, please provide your views on your preferred alternative(s) above or another alternative approach.

ACAG believes that the AASB should follow the developments in the IPSASB's ED 71 (approach (d)) and explore its potential suitability in Australia.

If the change in the conceptual framework for the private sector (specifically the definition of liability) is applied to the NFP and public sector (as the IPSASB is doing with their conceptual framework), then this is expected to require the recognition of additional obligations. Given the IPSASB approach, such obligations would appear to include obligations (under a binding agreement), to spend funds on specific projects or activities, or eligible / allowable expenditure. This approach would likely result in more grants revenue/income being recognised over time. However, we acknowledge that this would still likely result in judgement being required, of how detailed the requirements in the binding agreement need to be to conclude that outflows have been 'incurred in accordance with those requirements' to determine when to recognise the revenue/income.

Some jurisdictions have concerns with approaches (a), (b) and (c) and believe that the developments in the IPSASB's ED 71 may provide a better framework. Some of the concerns highlighted by jurisdictions on these approaches are highlighted below.

<u>Approach (a)</u>

- There needs to be an obligation in order to recognise a liability (under the conceptual framework) for deferred revenue.
- Is open to a high degree of interpretation about what the 'common understanding' actually is to determine the appropriate timing.
- May be more likely to be manipulated to achieve a specific result.
- An overreliance may result in a lack of consistency and comparability in reporting.

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: 11. the determination of whether the entity is a principal or an agent? 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? 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? 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.

Funding for grant and loan programs

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.

Example 3A of AASB 1058

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

<u>Costs versus benefits and difficulties in accounting for research grants</u>

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
Do you have any comments regarding: 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; 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.

Disclosure of statutory receivables

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
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
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
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
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
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.