

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
VICTORIA 8007

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By email: standard@asb.gov.au

Submission to the Australian Accounting Standards Board

Exposure Draft 260 'Income of Not-for-Profit Entities'

The Chief Financial Officers (CFOs) of the Group of Eight (Go8) Universities welcome the opportunity to comment on AASB Exposure Draft ED 260 '*Income of Not-for-Profit Entities*'. Please note that this submission represents the collective views of the CFOs of the Go8 network, although member universities may also make individual submissions that reflect their particular views or circumstances.

The Go8 CFOs are aware of the concerns that have been expressed for many years by a range of parties in respect to the income recognition requirements of the current standards; in particular in respect to AASB 1004 '*Contributions*'. While the individual universities that comprise the Go8 have particular views in respect to the requirements of the current standards, the Go8 CFOs are generally supportive of the introduction of a revised standard that provides clear guidance that reduces complexity and achieves common sense income recognition principles.

The AASB has stated that the proposed standard is a response to a review of AASB 1004 carried out by the AASB that addresses concerns raised by some constituents in respect to premature recognition of income and the view held by the AASB that the principles of AASB 15, should apply to not-for-profit entities.

Following a review of the proposed standard, the Go8 CFOs have concluded that there are a number of issues that arise from the proposed standard that require comment. Our detailed comments on the Board's proposals are attached.

Should you wish to discuss any aspect of our submission, please contact me directly at d.wright@sydney.edu.au

Sincerely,

David Wright
Director, Financial Control and Treasury
The University of Sydney

Executive Summary

The Go8 CFOs are generally supportive of the introduction of a standard that allows for improved matching of income and expenditures than that currently achieved under AASB 1004 *'Contributions'*. However, we are concerned that the proposed standard will not deliver that outcome and will result in outcomes that are ambiguous, highly complex to implement and will lead to recognition of similar income streams (i.e. grants and donations) under multiple standards.

We would support the AASB in modifying the proposed standard to provide clear and pragmatic guidance to income recognition principles that, in particular, delivers an outcome that grants and donations are recognised under a single standard.

The Go8 CFOs have particular concerns in respect to four issues arising from the proposed standard. Those are:

1. The additional administrative effort driven by ambiguity and complexity of the proposed income recognition requirements exceed the potential benefits arising from implementation of the proposed standard, either for a university or its stakeholders.
2. Recognition within the proposed standard that the university sector, perhaps uniquely, has significant revenue streams (grants and donations) that do not give rise to a transfer of a good or a service to either the donor or an external beneficiary.
3. In respect to accounting for donations where an 'in perpetuity' condition is placed on the recipient. Possible interpretations of the current proposals in ED 260 could result in:
 - a. the corpus of new donations never being recognised as income; or
 - b. the majority of the investment income generated from such donations not being reported as income; and
 - c. the reclassification of the value of perpetual gifts at the implementation date of the standard from retained earnings to unearned revenue.
4. Clarification of the term 'public sector not-for-profit entity' since it is not currently clear whether a university is or is not caught by this term.

We have also provided brief comments in respect to the specific matters for comment raised by the Board. In respect to Question 9, we are also of the view that the AASB should consider additional transitional relief for non-financial assets and finance lease assets and liabilities.

We would greatly appreciate the Board addressing the issues that we have identified and would value the opportunity to work further with the Board, should that be of mutual advantage, following the closure of the submission period.

1. Administration effort and complexity

Under AASB 1004, within the university sector, donations and grants have been classed as 'non-reciprocal' in nature and are generally recognised as income on receipt.

Conceptually, the operation of the proposed standard is relatively straight-forward. However, our interpretation of the proposals contained in ED 260 suggests that the intricacies of the requirements of AASB 15, together with the particular features of several of the income streams derived by universities, make the tests proposed in the draft standard very complex to implement and administer.

Under the proposed standard, a transaction arising from a contract with a customer or 3rd party would be recognised under AASB 10XX if there is no sufficiently specific performance obligation and under AASB 15 if the receipt is subject to an enforceable agreement and there is a sufficiently specific performance obligation. In either circumstance, it may be necessary to defer revenue depending on the existence of related liabilities (AASB 10XX) or satisfaction of performance obligations (AASB 15).

For example, a donation to support research (where there is no transfer of a good or service to the donor or to third party beneficiaries) would be recognised under AASB 10XX. However, an enforceable agreement to provide a donation to fund a scholarship (where there is a clear transfer of a good being the scholarship, to a 3rd party beneficiary being the student) would be recognised under AASB 15.

Collectively, during 2014 the Go8 received grants and donations worth \$4,161 million. We are concerned that the proposals will add considerable administrative time, effort and complexity to analyse the terms surrounding each individual transaction.

We also note that draft standard AASB 10XX at paragraph 6 states that "...a not-for-profit entity shall apply this Standard to an inflow of a resource...from each **donation, grant**...or other similar event." This drafting appears ambiguous as to the intent of the AASB that donations and grants are to be recognised under AASB 10XX rather than under either AASB 15 or AASB 10XX.

In our view, the proposed standard should be modified to ensure consistency of treatment for all grants and donations under a single standard, preferably within the ambit of AASB 10XX. We believe that this would improve the matching of income and expenditure and be advantageous in removing considerable complexity and ambiguity.

We recommend that the proposed standard be amended so that all donations and grants, whether subject to a contract or not, are recognised under AASB 10XX. This modification would allow recognition of related contractual liabilities and for revenue to be recognised as those liabilities are satisfied.

2. Definition of 'transfer of goods or services'

AASB 15 contains a fundamental requirement that an entity shall "...identify as a performance obligation each promise to transfer to the customer....a good or service that is distinct; or a series of distinct goods or services..."

The Go8 universities are potentially unique within the not-for-profit sector in that they receive substantial income from donations and grants from various sources. During 2014, across the Go8, the income received from these sources totalled \$4,161 million representing approximately 35% of the total income of the Go8 universities. In the majority of cases, donations and grants are documented through individual agreements that often establish conditions on the recipient but that do not include a requirement to transfer a good or a service to a customer or a third party.

In some cases there may be a customer or a third party to whom a good or a service is transferred and therefore, under the current drafting of the proposed standard, there may be a performance obligation. In such a circumstance, AASB 15 would apply. Where there is no such transfer and thus no performance obligation, it is likely that AASB 10XX will apply.

As discussed in Section 1 above, in order to reduce complexity we recommend that the proposed standard be amended to make it clear that donations and grants should be recognised under AASB 10XX, regardless of whether such transactions represent a contract with a customer. Recognition under AASB 10XX will allow for deferral of income recognition until any related liabilities have been satisfied. To ensure that income in respect to grants and donations is recognised solely under AASB 10XX, it follows that paragraph 12(a)(i) of AASB 10XX would be excluded from any recognised liabilities.

We recommend that the proposed standard be amended to require that donations and grants, whether subject to a contract or not, be recognised under AASB 10XX. Consequently, we recommend that contract liabilities to a customer arising from a performance obligation under AASB 15 [paragraph 12(a)(i) of AASB 10XX] be excluded from being a recognised liability for the purpose of paragraph 10(a) of AASB 10XX.

3. 'In perpetuity' endowments

Many Go8 universities receive donations from alumni and other benefactors. The terms of these donations are most often set out in a Deed of Gift, a Will or a Bequest. Under the current standard (AASB 1004), generally, the recipient controls these donations and recognises the income on receipt as a contribution.

Donors often impose conditions such as maintenance of the corpus in perpetuity or to spend the corpus; or where there is an 'in perpetuity' condition, the investment proceeds derived from the corpus, for a particular purpose.

In the case where the arrangement gives rise to 'in perpetuity' conditions, a possible interpretation of the proposals in ED 260 is that the corpus of the donation may never be able to be recognised as income under AASB 15. This arises since:

- a. On receipt of the donation, the satisfaction of the performance conditions cannot be met at that time; and
- b. There is no readily identifiable time period in which the conditions can ever be met.

Further, where the majority of the investment income derived from the corpus is required to be added to the endowment to maintain the real value of the donation, a possible interpretation of the proposals in ED 260 is that those funds would be recognised as an increment to the deferred revenue liability rather than as income.

Should the proposals in ED 260 be implemented in their current form, we are concerned that the value of a university's perpetual endowment would be transferred as an adjustment on implementation from equity to non-current liabilities as deferred revenue.

Each of these interpretations would have a substantial impact upon the financial statements of a university. A number of the Go8 member universities have large endowments and it is likely that any necessary adjustment would have a detrimental impact on the reported financial performance and position of those universities.

It is our view that reporting the receipt of donations that are subject to 'in perpetuity' conditions in the manner proposed within the draft standard does not faithfully represent the substance of the arrangement. Where a university has obtained control of the donation, we believe that it is appropriate to recognise the contributed asset and revenue at that time. We believe that a more appropriate solution is to require disclosure of any restrictions on the use and purpose of those funds.

We recommend that donations that have 'in perpetuity' conditions are treated as donations to which draft standard AASB 10XX applies.

4. Definition of 'public sector not-for-profit entity'

ED 260 currently uses the phrase 'public sector not-for-profit entity' which is not defined. It is not clear whether a university is or is not caught by this term.

We note that the same term is also used in ED 261 '*Service Concession Arrangements: Grantor*' and the Board's project on '*Reporting of Service Performance Information*' as well as AASB 124 '*Related Party Disclosures*'.

The lack of a definition of 'public sector not-for-profit entity' creates uncertainty and could lead to interpretation issues with State Government Audit Offices. In unofficial discussions with AASB staff, it was suggested that the Australian Bureau of Statistics Standard Economic Sector Classifications should be used to interpret this phrase.

However, ABS Bulletin 1218.0 issued in September 2002 indicates that, to ensure consistency, all universities have been classified to the general government sector.

We are strongly of the view that this classification is not appropriate given that most, if not all, universities are neither controlled nor consolidated by governments. We have further concerns with this classification in that there may be other significant accounting impacts that would potentially apply if universities are in fact classed within the general government sector.

We are strongly of the view that the term 'public sector not-for-profit entity' should be defined within accounting standards in order to make clear the intent of the AASB in using that term and to ensure that a public university is not defined as a 'public sector not-for-profit entity'.

5. Volunteer services

The proposed standard contains a requirement for the government sector generally to recognise volunteer services as income if the services can be measured reliably and the services would have been purchased had they not been donated. A 'public sector not-for-profit entity' may recognise such services as income even if the services would not have been purchased and where the services can be reliably measured.

One of the unique features of the university sector is the degree of association that is often exhibited by alumni and academic staff to their alma mater. As a result, many alumni and academic staff retain an association with their university that can remain throughout their life. Many alumni and retired staff freely donate their time where opportunity is available to support the university's academic life.

We are also of the view that revenue should ultimately be cash-backed; that is, that at some point, the recognition of the revenue should be backed by the receipt of cash (or the avoidance of expenditure). Nevertheless, we accept that some not-for-profit entities may wish to recognise the financial effects of volunteer services. Consequently, we agree with the proposals that the recognition of volunteer services should be optional.

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Specific matters for comment

1 *In relation to the AASB's proposal to replace the reciprocal / non-reciprocal transfer distinction in AASB 1004 with income recognition requirements based on whether a not-for-profit entity needs to satisfy a performance obligation:*

- (a) *do you agree that this proposal would provide a faithful depiction of a not-for-profit entity's financial performance?*
- (b) *if not, what alternative approach to income recognition would you recommend for not-for-profit entities? Please provide your reasons.*

In principle, we agree with the proposal while noting that there are likely to be a significant number of practical implementation issues arising from application of a strict performance obligation approach. We have discussed this matter as it applies to the university sector in Section 1 above.

2 *In relation to the AASB's proposal that, to qualify as a performance obligation, a not-for-profit entity's promise to transfer a good or service to a counterparty in a contract must be 'sufficiently specific' to be able to determine when the obligation is satisfied (see paragraph IG13 of Part A):*

- (a) *do you agree with this proposal?*
- (b) *if not, what factors or criteria should apply to determine whether a not-for-profit entity has a performance obligation? Please provide your reasons.*

We have discussed our concern with this aspect of the proposed standard in Section 2 above.

3 *Do you agree with the proposal in paragraphs IG19-IG30 of Part A that a not-for-profit entity would recognise a donation component in a contract with a customer as immediate income only if:*

- (a) *a qualitative assessment of available evidence indicates that the customer intended to make a donation to the not-for-profit entity; and*
- (b) *the donation component is separately identifiable from the goods or services promised in the contract?*

We agree with the principle in general whilst noting that its application within the university sector would be rare.

4 *In relation to the AASB's proposals to:*

- (a) *permit any not-for profit entity to recognise volunteer services as income if the fair value of those services can be measured reliably; and*
- (b) *carry forward the requirement in paragraph 44 of AASB 1004 that particular public service entities must recognise volunteer services if those services would also have been purchased if they had not been donated*

In principle, as discussed in Section 5, we agree with optional recognition of this proposal.

5 Do you agree with the proposal in paragraph 38 of [draft] AASB 10XX that, when inventories are donated to a not-for-profit entity other than as part of a contract with a customer, assessments of whether the donations are material should be made on an individual transaction basis without reassessment at a portfolio or other aggregate level?

We have no view on this matter since it seems unlikely that a Go8 university would be impacted by this matter.

6 Australian Accounting Standards applicable to for-profit entities do not include a definition of 'contributions by owners'. Further, concerns have been expressed by some that the definition of 'contributions by owners' in AASB 1004 is too narrow. Do you consider that a definition of 'contributions by owners' is still necessary, or appropriate, in Australian Accounting Standards? If so, would you prefer using:

(a) the definition of 'contributions by owners' presently in AASB 1004; or

(b) the definition of 'ownership contributions' in the Public Sector Conceptual Framework issued by the International Public Sector Accounting Standards Board (IPSASB)?

We have no view on this matter since it seems unlikely that a Go8 university would be impacted by this matter.

7 The AASB also seeks views on a range of issues related to contributions by owners.

We have no view on this matter since it seems unlikely that a Go8 university would be impacted by this matter.

8 In relation to disclosure requirements regarding compliance by government departments with appropriations:

We have no view on this matter since it seems unlikely that a Go8 university would be impacted by this matter.

9 Do you agree with the proposed transitional provisions in Appendix C of [draft] AASB 10XX? In particular:

(a) do you agree with the transitional provisions for non-financial assets and finance lease assets and liabilities, the cost of which was not measured at fair value on initial recognition; and

(b) do any other issues warrant additional transitional provisions and, if so, which transitional provisions do you suggest?

We are of the view that additional transition relief is required since in many cases it is impractical to establish the fair value of assets donated or granted to a university, especially where the donation or grant occurred early in the history of the university.

Conclusion

In general, the objectives of the AASB to improve the financial reporting of income of not-for-profit entities are supported by the CFOs of the Go8.

However, as discussed, we are of the view that the proposed standard as currently drafted contains a number of matters that are highly problematic for the sector generally and the Go8 in particular.

It is our view that it is possible to make amendments to the proposed standard that would address our concerns in respect to the universities' endowment funds and significant donation and grant income streams. We have made recommendations that would, in our view, considerably reduce the complexity and administrative burden associated with implementation of the proposed standard in its current form.

We would value the opportunity to work further with the AASB following the closure of the submission period and we thank the AASB for the process that has been completed to date.

The Chief Financial Officers of the following Universities support this submission and we note that each of these universities may also make individual submissions.

Australian National University

Monash University

The University of Adelaide

The University of Melbourne

The University of New South Wales

The University of Queensland

The University of Sydney

The University of Western Australia

