Australian Government

Australian Accounting Standards Board

Staff Paper

Project:	**Income of Not-for-Profit Entities (AASB 1058 and AASB 15 NFP guidance) – narrow-scope amendments**	**Meeting:**	AASB April 2022 (M186)
Topic:	**Staff analysis of feedback on ED 318**	**Date of this paper:**	22 March 2022
Contact(s):	Carmen Ridley cridley@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Agenda Item:**	5.1
		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider feedback on ED and decide next steps

Objectives of this agenda item

1 The objective of this agenda item is:

(a) to **inform** the Board of feedback received on AASB Exposure Draft ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets*;

(b) to **consider** staff analysis and recommendations on the issues raised by stakeholders; and

(c) to **decide** on next steps.

Attachments

Agenda Paper 5.2 Submissions received on ED 318 [supporting documents folder]

Agenda Paper 5.3 For noting: ED 318 [supporting documents folder]

Structure

2 This paper is structured as follows:

(a) Background and reasons for bringing this agenda item to the Board (paragraphs 3–10);

(b) Summary of staff recommendations (paragraphs 11–14)

(c) List of respondents to ED 318;

(d) High-level summary of feedback from respondents (paragraphs 15–17);

(e) Part A – Proposed amendment to AASB 15 Illustrative examples (paragraphs 18–25);

(f) Part B – Proposed amendments to AASB 1058 Illustrative examples (paragraphs 26–99);

(g) Part C – Concessionary leases (paragraphs 100–105);

(h) Next Steps (paragraphs 106–109);

(i) Appendix A: Revised amendments to AASB 15 example 7A; and

(j) Appendix B: Revised amendments to AASB 1058 example 3A.

Background and reasons for bringing this agenda item to the Board

Income of not-for-profit entities – Illustrative examples

3 At its September and November 2021 meetings, the Board considered comments from stakeholders in the not-for-profit (NFP) sector following the implementation of AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities*.[1] Some stakeholders were concerned that the analysis and accounting treatment in the cash scholarship endowment example in Illustrative example 3A accompanying AASB 1058 potentially was unclear. These stakeholders suggested that the example may lead to diversity in recognising a financial liability because the example does not explain sufficiently whether recognition of a financial liability is required for any funding received by an entity that is subsequently directed to other recipients and income recognised for the portion of the funding retained.

4 Stakeholders also noted concerns about the diversity of practice in accounting for upfront fees received by NFP entities. Where the NFP entity recognises revenue within the scope of AASB 15 and a non-refundable upfront payment is charged to the customer, AASB 15 paragraphs 22–30, B48–B51 and F20–F27 require an entity to assess whether the upfront fees relate to the transfer of a promised good or service. If the upfront fees relate to a transfer of goods or services, revenue is recognised over the time the service or goods are provided, rather than on receipt of the funds. Stakeholders raised this issue from the perspective of diversity in practice, where:

(a) some entities are deferring revenue (and recognising a contract liability in accordance with AASB 15); and

(b) other entities are continuing to recognise revenue on receipt of fees which, prima facie, look very similar.

Stakeholders also indicated that the principle of deferral is confusing to boards, management committees, members and other users as the amounts received are not refundable. Stakeholders requested further guidance to clarify the principle and why a contract liability is recognised when the funds will never be repaid.

5 The Board considered the stakeholder comments and assessed with reference to the *AASB Not-for-Profit Entity Standard-Setting Framework*. Whilst the original conclusions in the Illustrative example 3A in AASB 1058 are appropriate, the Board decided to propose amending the example to clarify the conclusion further and adding an example to illustrate a contrasting scenario. The Board also decided to propose adding an Illustrative example to AASB 15 to address the issues that stakeholders raised regarding upfront fees received that are in the scope of AASB 15. The Board decided not to propose amendments to AASB 15 and AASB 1058 regarding other comments received from stakeholders. The Board will consider the feedback in the forthcoming post-implementation review (PIR) of AASB 1058 and guidance for NFP entities in AASB 15. As part of the narrow-scope project, the AASB staff also prepared additional educational material to assist with applying these Standards.

Concessionary leases

6 AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* provided an optional exemption from the initial fair value measurement

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1 Minutes of the AASB meeting on 8-9 September 2021, Minutes of the AASB meeting on 10-11 November 2021.

requirement and allowed NFP entities to elect to measure right-of-use (ROU) assets arising under concessionary leases at cost. The Board indicated that the accounting policy choice to measure such ROU assets at cost is only a temporary exemption from the initial fair value requirement. The Board noted that it would reassess the initial measurement requirement for ROU assets under concessionary leases in the future.

7 At its November 2021 meeting, the Board considered feedback from NFP private sector stakeholders that uncertainty exists whether fair value information needs to be obtained for concessionary leases. This uncertainty exists because it is unclear whether the Board would be likely to require the retrospective application of the initial fair value requirement if it decides in the future to remove the accounting policy choice. The Board considered stakeholders' comments and decided to propose to retain the accounting policy choice to initially measure ROU assets arising under concessionary leases at cost on an ongoing basis to provide certainty to NFP private sector lessees.

8 Regarding NFP public sector lessees, the Board considered that a decision about the initial measurement of ROU assets arising under concessionary leases be deferred until the discussion of additional guidance on measuring the fair value of such ROU assets. The Board decided to consider outcomes of the concessionary leases part of the IPSASB's current Leases project and the AASB's forthcoming Exposure Draft proposing modifications to AASB 13 for NFP public sector entities before reconsidering the application of fair value for concessionary leases in the NFP public sector.

9 The Board noted concerns raised by public sector stakeholders regarding the difficulty of measuring the fair value of historical concessionary leases. However, the Board decided not to propose grandfathering existing concessionary leases from a possible future fair value requirement unless it decides to remove the accounting policy choice to initially measure ROU assets arising under concessionary leases at cost.

10 In January 2022, the Board issued AASB Exposure Draft ED 318 for comment. Comments were due by 11 March 2022.

Summary of staff recommendations

11 Staff recommend in respect of the Illustrative examples in AASB 15:

(a) that example 7A, as outlined in Appendix A: Revised amendments to AASB 15 example 7A to this paper, be added to the Australian Illustrative examples for Not-for-Profit Entities accompanying AASB 15;

(b) a comment noted in paragraph 24(c) be added to staff FAQs 11 and 12 to clarify that the examples illustrate the specific application of AASB 15 example 7A.

12 Staff recommend in respect of Illustrative examples in AASB 1058:

(a) to proceed with the further work to improve the illustrative example whilst considering the feedback on ED 318 proposals suggested by the stakeholders;

(b) not to proceed with the proposals as outlined in ED 318. Instead, use the example as currently worded in AASB 1058 as a base to incorporate changes recommended by staff in paragraphs 47–99 (and listed in (c)–(i) below) to reflect feedback on ED 318 as appropriate as outlined in Appendix B: Revised amendments to AASB 1058 example 3A;

(c) to clarify considerations relevant for principal versus agent assessment and the trigger for the consideration of derecognition criteria in AASB 9 in the existing example 3A;

(d) to clarify in the existing example 3A the considerations to be taken into account when assessing the existence of the financial liability, specifically regarding the definition of the financial liability being contractual obligation to deliver cash to another party;

(e) to extend the current reference "Chapter 3 'Recognition and derecognition" in existing example 3A to include steps for entities to consider in the derecognition assessment;

(f) to include a high-level overview of financial liability derecognition considerations to enhance the existing example 3A including the conclusion that the settlement of the liability would not have profit or loss impact unless there is a difference between the carrying amount and consideration paid;

(g) not to proceed further with proposed example 3A.2;

(h) no changes to the other examples be made other than editorial clarification to ensure the scenario in example 3B remains intact if needed and to defer wider review of existing illustrative examples to the PIR;

(i) incorporate the proposed amendments in section "Accounting treatment" in the first paragraph on page 11 of ED 318 into the existing example 3A.

13 Staff recommend in respect of concessionary leases:

(a) to proceed with proposals as exposed in ED 318 and not to amend the proposals in respect of public sector ROU assets from concessionary leases.

14 Staff recommend issuing a fatal-flaw review draft with a comment period of two weeks.

List of respondents to ED 318[2]

Category	Respondent
6 - Professional Services firms	BDO
	Ernst & Young (EY) [verbal feedback][3]
	Deloitte
	KPMG
	Nexia
	PricewaterhouseCoopers (PwC)
1 - Professional Bodies	Chartered Accountants Australia & New Zealand/CPA Australia (CAANZ & CPA) – joint submission
1 - Regulators	Australian Charities and Not-for-profits Commission (ACNC)
1 - Public Sector Audit Offices	Australasian Council of Auditors General (ACAG) – representative body submission
1 - Public Sector Preparers	Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) – representative body submission

High-level summary of feedback from respondents[4]

15 Half[5] of the respondents to ED 318 supported the proposed amendment to AASB 15 Illustrative examples. The remaining respondents recommended that any changes to the

2 Staff encouraged stakeholders to provide feedback at various outreach events, including Staff education webinar on 2 March 2022, Not-for-Profit Project Advisory Panel on 8 March 2022 and ACNC Adviser Forum on 16 March 2022.

3 EY were supportive of concessionary leases proposals for both NFP private and public sector.
In respect of Example 7A, they considered proposals too generic as the requirements are already in the Standard and therefore not providing much additional value and suggested to amend and apply to a particular type of the entity (and possibly different to the school's scenario in Staff FAQs), for example clubs, professional body, gym, union membership. They also recommended to consider including the Staff FAQs on the upfront fees from as illustrative examples in the Standard.
Regarding proposed Examples 3A.1 and 3A.2, EY recommended to consider whether the proposed amendments at this stage provide sufficient value-add whether should be considered as part of PIR especially if the proposals would attract diverse feedback. They have following concerns with the proposed amendments:
- cash scholarship scenario to use at student's discretion is unrealistic and the AASB should consider adding conditions such as requirement to enrol a class, use for accommodation and study-related activities. Such scenario would then however needs to be considered whether in scope of AASB 15;
- clarification is warranted in respect of the term "as directed by alumnus" as it is not clear whether the university is in the position of agent instead of principal;
- clarification required why the financial liability has been recognised at inception in the same amount as the asset amount (and not discounted) unless the financial liability include demand-feature;
- clear articulation of the meaning "unless another Standards addresses the accounting for the difference, such as the "day one gain/loss" requirements in AASB 9" in the context of illustrated example;
- an example illustrating non-financial obligation referred to in AASB 132.20a would be more practical.

4 This paper uses the following terms to describe the extent to which particular feedback was provided by respondents:

Term	*Extent of response among respondents*
Almost all	all expect a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

5 ACNC, PwC, ACAG, Deloitte and HoTARAC.

Standard be dealt with as part of the forthcoming PIR. Generally, the respondents did not have any issues with the recognition and measurement concepts illustrated; some respondents provided additional feedback, which is considered in Part A – Proposed amendment to .

16 Most[6] (8 of the 10) respondents to ED 318 did not support the proposed amendment to AASB 1058 Illustrative example 3A and noted several concerns with the illustrated scenario and accounting analysis. Also, six of the respondents noted these were not desirable at this time and recommended considering any amendments as part of PIR. In contrast, four respondents supported amending Example 3A at this time. This feedback is considered in Part B – Proposed amendments to AASB 1058 Illustrative examples.

17 Almost all[7] (9 of the 10) respondents agreed with the Board's decision regarding the ROU assets arising from concessionary leases for NFP private sector entities.[8] One respondent (HoTARAC) disagreed with the decision to defer the decision regarding NFP public sector ROU assets arising from concessionary leases. Further details of the feedback are provided in Part C – Concessionary leases.

Part A – Proposed amendment to AASB 15 Illustrative examples

Illustrative Example 7A

18 As noted in paragraph 15, respondents were evenly split between those:

(a) supporting the proposed amendment to AASB 15 Illustrative example 7A[9] and;

(b) recommending that changes to AASB 15 be deferred until the PIR.[10]

19 The respondents recommending deferral of the amendments to the PIR noted that the example was generic and did not provide any additional guidance to that already included in AASB 15. However, these respondents did not note any fundamental issues with applying recognition and measurement principles illustrated in the proposed amendment.

20 Four[11] respondents provided additional feedback on drafting. This feedback is incorporated into the revised example shown in Appendix A: Revised amendments to AASB 15 example 7A to this paper as follows:

(a) the fixed nature of the contract may indicate that this is only relevant for fixed contracts, and therefore, the facts have been changed to ongoing services;

(b) change made due to a respondent comment that the terminology should be consistent with AASB 15 to avoid ambiguity;

(c) change made to reflect that fund provider needs only the ability to enforce;

(d) changes to further clarify why the fee is treated as an advance payment of future services per recommendation by respondent. The term of revenue recognition has been updated to reflect the removal of the fixed term contract.

Staff analysis and recommendation

21 Staff considered the feedback received from stakeholders that the example is too generic. Staff note that the proposed amendments to the example were to address earlier feedback that the existing staff FAQ was too specific as the FAQ was perceived to be only applicable to

6 ACAG, Deloitte, EY, Nexia, PwC, KPMG, CAANZ & CPA, BDO
7 ACNC, Nexia, PwC, ACAG, KPMG, CAANZ & CPA, BDO, Deloitte, EY
8 ACAG did not comment on the questions in relation to NFP private sector entities
9 ACNC, ACAG, PWC, Deloitte and HoTARAC
10 Nexia, CAANZ & CPA, KPMG, BDO and EY
11 ACAG, KPMG, PWC and Nexia

private schools. Staff consider that the generic example will assist those NFP entities with limited access to technical accounting resources in implementing the requirements of AASB 15 regarding upfront fees, regardless of the entity type.

22 Staff have also considered drafting and editorial suggestions noted by some stakeholders and updated the proposed Illustrative example 7A. The revised wording is provided in Appendix A to this paper.

23 Based on the above analysis, staff recommend that example 7A, as outlined in Appendix A to this paper, be added to the Australian illustrative examples for NFP Entities accompanying AASB 15.

Question for Board members	
Q1	Do Board members agree with the recommendation in paragraph 23 that revised illustrative example 7A, as outlined in Appendix A to this paper, be added to AASB 15 Illustrative examples? If the Board does not agree with the staff recommendation, how would the Board like to proceed concerning illustrative example 7A?

AASB Staff FAQ 11 and FAQ 12

24 Five respondents[12] provided recommendations concerning the existing staff FAQ 11 and FAQ 12 on upfront fees in private schools, which are summarised below:

(a) **Option 1**: withdraw staff FAQs 11 and 12;

(b) **Option 2**: incorporate staff FAQs 11 and 12 into AASB 15 as additional Illustrative examples; and

(c) **Option 3**: add a comment in staff FAQs 11 and 12 to clarify that these examples are a specific application of illustrative example 7A in AASB 15, for example, adding the following comment: "these examples illustrate a specific application of AASB 15 Example 7A to private schools".

Staff analysis and recommendation

25 Staff have considered alternatives for the existing staff FAQs and, given the short-term nature of this project, recommend Option 3 outlined in paragraph 24(c) above to add a comment to FAQs 11 and 12 to note that these are a specific application of Example 7A of AASB 15. This option allows all guidance and staff educational material to be retained and provide a link between the examples. Staff do not recommend the remaining options for the following reasons:

(a) Option 1: withdrawing staff FAQs 11 and 12 would remove guidance that is useful to a particular sector and provide more detailed guidance about a specific transaction; and

(b) Option 2: incorporating FAQs 11 and 12 into AASB 15 would make changes to the accompanying sections of AASB 15. Whilst the Illustrative examples are not part of AASB 15, the Board would need to consider whether any change should go through due process, which would not be in accordance with the short-term nature of this project.

Staff also note that the PIR would include a review of the location and content of staff FAQs about income of NFP entities.

12 PwC, BDO, EY, ACAG and KPMG

Questions for Board members

Q2 Do Board members agree with the recommendation in paragraph 25 that a comment noted in paragraph 24(c) be added to staff FAQs 11 and 12 to clarify that the examples illustrate the specific application of AASB 15 example 7A (Option 3)? If not, how would the Board members like to proceed with the existing staff FAQs 11 and 12?

Part B – Proposed amendments to AASB 1058 Illustrative examples

Timing of any amendments to AASB 1058

26 As noted in paragraph 16, most (8 of the 10) of the respondents to ED 318 did not support the proposed amendment to Illustrative example 3A of AASB 1058. They noted several concerns with the illustrated scenario and accounting analysis. Further, concerning the timing of any amendment:

(a) six[13] of the respondents did not support making amendments at this time and recommended considering any amendments as part of the PIR; whereas

(b) four[14] respondents supported amending example 3A at this time.

27 Those stakeholders that did not support proceeding with the proposed amendments at this time noted that whilst the existing example is unclear (KPMG), the main question to be addressed is whether the NFP entity is principal or agent and whether it should recognise the funds received and monies spent on gross or next basis. They also noted that answer to this question might represent a significant change to current practice (PwC). They recommended deferring any amendments to the forthcoming PIR review to address issues holistically.

28 The main reasons given by those respondents for not proceeding with the amendments at this time were:

(a) potential significant change in practice if the assessment of principal versus agent would result in net recognition including the need for transitional provisions (PwC);

(b) a change in accounting treatment may reduce the size of many charities, which means that they may no longer be required to lodge any financial reports with the ACNC and will no longer be subject to audit or review and, as such, would need to be discussed with ACNC (PwC, BDO);

(c) the reasons and bases for the conclusions reached have the potential for users to draw incorrect conclusions on alternative fact sets (Nexia); and

(d) the scenarios illustrated in the examples (both examples 3A.1 and 3A.2) do not reflect the practice. However, the complexities of more realistic scenarios that would be most beneficial to stakeholders should be addressed during the PIR (KPMG, CAANZ & CPA, BDO, EY).

29 On the other hand, four of the respondents agreed that the amendments are warranted as the existing example 3A is unclear why a financial liability should be recognised and assist NFP organisations in applying the accounting Standards and reducing divergence in practice. However, some respondents noted significant concerns with the proposed amendments. For example:

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13 Nexia, PwC, KPMG, CAANZ & CPA, BDO, EY

14 ACNC, ACAG, Deloitte, HoTARAC

(a) Deloitte noted the potential unintended consequences in a possible change in the gross versus net income recognition and its interaction with ACNC reporting thresholds.

(b) ACAG noted that the proposed Example 3A.1 requires further clarification to support the accounting analysis and conclusions and recommended waiting until IPSASB redeliberation on its Revenue project if the AASB believes that recognising a liability is the right outcome in this scenario.

30 Most respondents, both those that recommended deferral to PIR and those that supported amendments at this time, noted several comments and concerns with the proposed amendments that staff analysed further below in paragraphs 47–99 in respect of:

(a) lack of explicit consideration of principal versus agent assessment;

(b) existence of the financial liability – financial instrument definition;

(c) initial recognition and measurement of the financial liability;

(d) subsequent measurement of the financial liability;

(e) clarification of the use of income and principal towards the NFP objectives in example 3A.2;

(f) clarification of examples 3B, 3C and other examples in AASB 1058 and AASB 15; and

(g) other drafting and editorial comments.

Staff analysis and recommendations

31 Staff note that the Board proposed the amendments to example 3A accompanying AASB 1058 after considering the feedback from stakeholders that the analysis and accounting treatment of the cash scholarship endowment is potentially unclear.

32 Staff note that whilst none of the respondents disagreed that example 3A needs clarification, the feedback on the proposed amendments varied significantly from the agreement with the proposals with some clarifications requested to significant concerns with conclusions and suggestions to change the focus of the example considerably.

33 Staff have identified the following options for how to progress:

(a) **Option 1**: Do not proceed with further work in respect of example 3A and either:

(i) **Option 1A**: Retain the example as currently worded in AASB 1058 without amendments; or

(ii) **Option 1B**: Remove example 3A from AASB 1058 (whilst keeping existing examples 3B and 3C)

(b) **Option 2:** Proceed with further work in respect of the existing example 3A, taking into account feedback received on ED 318 when considering how to proceed.[15]

34 When analysing the options identified in paragraph 33, staff have considered the stakeholders' feedback in light of the AASB *Due Process Framework* requirements, including cost/benefit considerations outlined in para. 7.8.5 of the Framework whether the cost of implementing the proposals are expected to exceed the benefits.

35 Staff also note that:

15 Note that, if Board members agree with Option 2, staff will ask the Board to consider the further staff analysis and recommendations as to how to address the feedback from ED 318 in paragraphs 47–99.

(a) the primary aim of the example is to illustrate the interaction between AASB 1058 and AASB 9, specifically in respect of the identification of related amounts (AASB 1058, para. IE3); and

(b) the primary aim of the proposals in ED 318 was to address the feedback from stakeholders that the current example is potentially unclear.

36 Staff consider that addressing some of the feedback from stakeholders to explore broader or different scenarios focusing on principal versus agent or more typical scenarios could result in other complexities. Such scenarios would then need to be considered for potential application of AASB 15 and therefore would go beyond the intent of the example and the scope of this short-term narrow-scope project.

37 Staff analysed the arguments in favour and against Option 1 (including Option 1A and Option 1B) and Option 2 identified in paragraph 33 as follows:

(a) Option 1 – given the significance and diversity of the feedback received on the ED 318 proposals (including the theme of the illustrative scenario, its scope and accounting analysis and conclusions), Option 1 proposes not to proceed with further work on example 3A as part of this project given its short-term nature and narrow scope and giving regard to the forthcoming PIR. Staff have identified two options for the Board to consider – whether to keep existing example in the AASB 1058 (Option 1A) or whether to remove the example entirely (whilst keeping examples 3B and 3C) (Option 1B):

(i) Option 1A – keeping the example as is currently included in AASB 1058 does not provide further guidance and therefore does not address the feedback from stakeholders; however, at the same time does not result in further confusion and potentially significant change in practice. This option aligns with the narrow-scope nature of the project and addresses the feedback from stakeholders to defer any changes for consideration as part of the PIR. This option, however, does not allow incorporating some of the feedback from ED 318 into the existing example to improve its clarity.

(ii) Option 1B – removal of the example in its entirety would remove a source of uncertainty. However, it would also remove a helpful illustration of the interaction between AASB 1058 and AASB 9 and would not provide an opportunity to update the example.

(b) Option 2 – proceeding with further work to improve the existing example whilst considering the feedback on ED 318 proposals suggested by the stakeholders and analysed by staff in paragraphs 47 – 99. Staff note that this option provides the opportunity to further clarification as to what requirements of the Standards should be considered in the illustrated scenario and consequently, this option allows to address the feedback from targeted outreach to improve the clarity of the accounting analysis in the example. However, staff note that some stakeholder feedback the proposals may result in a change of practice for some entities where stakeholder feedback varied significantly. Staff also considered that the feedback from stakeholders on ED 318 provided new information that the Board did not possess at the time of approval of the ED, and whilst some changes would be beyond the scope of the narrow-scope project that the Board did not intend when approving the project and the resulting ED 318, some may not. The collected feedback also provides helpful information for the forthcoming PIR. Staff also noted whilst some of changes would be in line with the narrow-scope project, the impact of those changes would not be. Adding further detail on the application of AASB 9 is likely to go beyond the aim of the illustrative example and may introduce interpretation of AASB 9 requirements.

38 On balance, staff recommend Option 2. That is, to proceed with the further work to improve the illustrative example whilst considering the feedback on ED 318 proposals suggested by the stakeholders. The example is currently presented in AASB 1058. It is a useful illustration of the interaction of the Standard with AASB 9, including considerations under AASB 9 to be taken into account. Staff further note that the example is not a mandatory part of the Standard, so it cannot change the requirements. This option, however, provides the opportunity to assess how to address some of the feedback on ED 318 as recommended by staff in paragraphs 47–99.

Question for Board members

Q3 Do Board members agree with the recommendation in paragraph 38 to proceed with the further work to improve the illustrative example whilst considering the feedback on ED 318 proposals suggested by the stakeholders (Option 2)?

If Board members agree with the staff recommendation to proceed with Option 2, staff will ask the Board to consider the further staff analysis and recommendations as to how to address the feedback from ED 318 in paragraphs 39–99.

Q4 If Board members disagree with the staff recommendation, how would Board members like to proceed?

Approach to proposed AASB 1058 amendments

Note: This section is relevant only if the Board agrees with the staff recommendation in Question 3

39 Staff note that the key objective of example 3 is to illustrate the interaction between AASB 1058 and AASB 9, specifically regarding identifying related amounts (AASB 1058, para. IE3). Further, the primary aim of the ED 318 proposals was to address the feedback from stakeholders that the current example is potentially unclear.

40 In receiving feedback on ED 318, in the staff's view, addressing many of the issues raised in the feedback would be beyond the scope of the narrow-scope project that the Board did not intend when approving the project and the resulting ED 318. However, this detailed feedback provides helpful information for the forthcoming PIR.

41 Staff also considered that some of the feedback from stakeholders on ED 318 provided new information that the Board did not possess at the time of approval of the ED, such as:

(a) diverse views of the stakeholders whether the scenario illustrated in the example does result in a financial or other liability and under which circumstances;

(b) concern with example 3A extends to principal versus agent assessment as opposed to the recognition and measurement of the financial liability; and

(c) the clarification of the illustrative example as proposed would potentially lead to a significant change in practice.

42 Although the proposed amendments only relate to the illustrative examples, staff acknowledge that a significant change in an illustrative example may compel some entities' need for change in practice if applying the Standard requirements differently to their current application. If such significant change in practice would arise, it may indicate the need for a broader review of the Standard's application and its requirements.

43 Given the diversity in feedback received on ED 318, staff have identified several options for the Board to consider for how to proceed with amending the example:

(i) **Option 1:** Not to proceed with the proposals outlined in ED 318. Instead, use the example as currently worded in AASB 1058 as a base to incorporate changes recommended by staff in paragraphs 47–99 to reflect feedback on ED 318 as appropriate.

This option acknowledges the feedback received from stakeholders and incorporates some of the feedback from ED 318 into the existing example to improve its clarity whilst maintaining the intended narrow-scope nature of this project;

(ii) **Option 2:** Proceed with the proposals in ED 318 whilst incorporating some or all of the changes suggested by stakeholders analysed in paragraphs 47–99. For example, revisit the scenario resulting in the financial liability and provide further details on the accounting for the financial liability.

Whilst some of the suggested changes would be in line with the narrow-scope project, the impact of the changes would not be. In addition, these changes are likely to go beyond the aim of the illustrative example and may introduce interpretation of AASB 9 requirements.

(iii) **Option 3:** Amend the example as proposed in ED 318 through a significant revision to the proposed amendments to reflect feedback from stakeholders. In particular, consider amendments in paragraphs 47–58 regarding the principal versus agent considerations, including revising the scope and fact patterns illustrated in the example.

Amending the scenarios to make them more realistic and further clarification of the conclusions arrived to in the illustrative example would provide a more conclusive and practical illustration. However, with the increased risk of significant impact to the practice, including the likely need to re-expose the proposals that will be beyond the scope of the narrow-scope project.

44 Consequently, staff do not recommend proceeding with the amendments as proposed in ED 318 after considering feedback from stakeholders analysed in paragraphs 47–99. The feedback indicates that the proposals, even after the feedback is addressed (i.e. Option 2), may significantly impact practice, which would be beyond the project's original scope.

45 For the same reason, staff do not recommend addressing the feedback from stakeholders to explore broader or different scenarios focusing on principal versus agent or more typical scenarios, which could result in further complexities in practice (Option 3).

46 Therefore, staff recommend Option 1. That is, not to proceed with the proposals outlined in ED 318. Instead, staff recommend using the example as currently worded in AASB 1058 as a base to incorporate changes recommended by staff in paragraphs 47–99 to reflect feedback on ED 318.[16]

Question for Board members

Q5 Do Board members agree with the recommendation in paragraph 46 to follow Option 1? That is, not to proceed with the proposals outlined in ED 318. Instead, use the example as currently worded in AASB 1058 as a base to incorporate changes recommended by staff in

16 Note that Appendix B: Revised amendments to AASB 1058 example 3A contains draft revisions to the existing example 3A in AASB 1058 reflecting staff recommendations in paragraphs 47–99. Question 5 to the Board is not asking the Board to opine on those specific amendments, but rather is asking the Board to provide a view on whether the the starting point for re-deliberating the proposals should be the existing example in AASB1058 or the proposals in ED 318.

paragraphs 47–99 to reflect feedback on ED 318? If not, how would the Board members like to proceed?

Note to Board members: The following discussion (and the drafting in Appendix B to this paper) reflects staff recommendations that follow if the Board agrees in Question 5 above to use the example as currently worded in AASB 1058 as a base to incorporate changes to reflect stakeholder feedback on ED 318.

If the Board does not agree with the staff recommendation in Question 5, the staff analysis in the paragraphs 47–99 is relevant for the Board's deliberations, however, the drafting of Appendix B will not be applicable as it is prepared to reflect the staff recommendations.

Lack of explicit consideration of principal versus agent

47 Most stakeholders (Nexia, PwC, ACAG, KPMG, BDO, Deloitte, EY) commented that the issue identified during the project outreach being the lack of specific guidance either in Appendix F of AASB 15 or AASB 1058 concerning the principal versus agency distinction was not addressed clearly in the proposed amendments to the example 3A. In particular, they noted:

(a) this issue is most relevant for entities that receive donations that are 'passed through' the entity and ultimately end up with another entity. For example, any example should focus on whether or not income and expense should be recognised on a gross or net basis, as opposed to whether there is a financial liability (PwC);

(b) Example 3A.1 does not explain the significance of the scholarships being paid at the direction of the alumnus (as opposed to the university having the discretion to determine the scholarships paid) concerning the conclusions and whether these would vary if the payments were made at the discretion of the university (ACAG, EY);

(c) it is unclear what is the trigger event to contemplate whether the financial asset has been derecognised (KPMG);

(d) it is not necessary to consider the pass-through arrangement and a simpler scenario. For example, recognising cash as the university becomes a party to the contractual provisions of the instrument would be more practicable if it included the university deciding on the scholarship. Whilst example 3A.1 is silent on the presentation in profit or loss; there may be diversity in practice (gross versus net presentation). However, the principal versus agent principle would require further consideration as part of the PIR (BDO); and

(e) inclusion of pass-through discussion and derecognition analysis in the proposed amendments indicates that the university is a principal. However, this interpretation may not be appropriate as the example includes some indicators of the university being an agent and may lead to inappropriate principle versus agent assessment in practice, and therefore recommend to improve linking of the derecognition and pass-through analysis to principal versus agent assessment (Deloitte).

Staff analysis and recommendation

48 Staff agree that the proposed example 3A.1 could be further improved by clarifying the principal versus agent considerations, including linkage to the pass-through and derecognition assessment.

49 Staff, however, note the diversity in the respondents' views whether the pass-through considerations should be even considered. For example, feedback from respondents ranged from:

(a) consideration of principal versus agent would be better considered as part of the post-implementation review process; to

(b) recommendations to clarify the link between the pass-through requirements and derecognition assessment with the principal versus agent assessment.

50 Staff also note that the analysis in the existing example 3A already includes the conclusion that the university determined it controls the financial asset of $2 million as endowment upon receipt in cash and recognises the asset in accordance with AASB 9.

51 Staff highlight that principal versus agent assessment and whether, as a result, an entity becomes a party to the contractual provisions of a financial instrument depends on the substance of the contractual arrangements and consideration of all relevant facts and circumstances and requires judgement.

52 Regarding the principal versus agency assessment for a financial instrument, staff also note that the IFRS IC discussed principal versus agent in respect of centrally cleared derivatives, where, in respect of the scenario presented, the IFRS IC concluded that:

(a) an entity first assesses whether the transaction results in a contract in the scope of IFRS 9, and if it does, then the entity applies the requirements of IFRS 9; and

(b) if a transaction is not in the scope of IFRS 9 and another Standard does not specifically apply, then an entity applies the hierarchy principle in IAS 8 to determine an appropriate accounting policy.

53 Staff consider that the question of the applicable Accounting Standard and its scope will determine how the principal versus agent considerations should be assessed. In the proposed example, the university determined that it is a party to a contractual arrangement that gives rise to a financial instrument as it received a financial asset (cash) that it controls. The university, therefore, recognised that asset in the statement of financial position in accordance with paragraph 3.1.1 of AASB 9. The assessment of whether an entity is a party to contractual provision of a financial asset and whether it should recognise the asset in the statement of financial position could include consideration of who the legal owner of the asset is, who the beneficial owner is and the resulting rights of the entity. In performing the analysis, the entity may refer to the definition of an asset and the guidance on the concept of 'control' in the Conceptual Framework. Changing the focus of the example on the principal versus agent considerations would likely extend the scope of changes to the example beyond this project's scope, which focusses on clarifying the recognition and measurement of the financial liability.

54 Staff analysed whether the agreement gives rise to the financial instrument regarding the agreement to apply the principal amount of the endowment to the cash scholarships in paragraphs 59–66 below. If the entity determines that it has become party to the contractual provisions of the financial instrument, in the scenario illustrated in the example, then it also needs to consider derecognition requirements of AASB 9 given that the principal amount of the endowment must be applied towards funding cash scholarships at some time in the future (as directed by the principal), and such consideration was noted in the existing example 3A and in the proposed amendments. Whilst staff agree with stakeholder feedback that ultimately the pass-through criteria are not met (see analysis in paragraphs 67–75), staff do not agree that the consideration of derecognition criteria is not applicable as there is an event/condition that needs to be assessed for the derecognition (i.e. the fact that the university agreed to pass on the cash upon the direction of the alumni which could represent transfer of a financial asset as defined in paragraph 3.2.4 of AASB 9).

55 Staff agree that the linkage between recognising the financial asset and derecognition considerations as outlined above could be improved in the example to clearly specify the

trigger for considering the derecognition criteria of AASB 9 such as pass-through criteria and other derecognition criteria in section 3.2 of AASB 9 as applicable.

56 As the illustrative example illustrates the interaction between AASB 1058 and AASB 9, staff do not think that the scenario should focus on principal versus agent relationship considerations. In the staff's view, if the illustrated scenario would focus on principal versus agent considerations more generally, that would be beyond the scope of the narrow-scope project. This view aligns with the majority of the feedback received.

57 In addition, the proposed amendments aimed to clarify the existing example regarding the accounting for financial liability, not to revisit the illustrated scenario in its entirety. Whilst this may be helpful to stakeholders, it is beyond the project's scope and would require broader discussion that is better suited for the PIR.

58 Therefore, staff recommend clarifying the considerations relevant for the principal versus agent assessment and clarifying the trigger for considering the AASB 9 derecognition criteria. As noted above, due to the diverse feedback on the outcome of principal versus agent assessment of the proposed example ED 318, staff recommend including these considerations into the existing example 3A in AASB 1058 as drafted in Appendix B: Revised amendments to AASB 1058 example 3A.

Question for Board members

Q6 Do Board members agree with the recommendation in paragraph 58 to clarify the considerations relevant to principal versus agent assessment and the trigger for considering the derecognition criteria in AASB 9 in the existing example 3A? If not, how would the Board members like to proceed?

Existence of the financial liability – definition of financial instrument

59 One stakeholder (ACAG) commented that the updated example does not refer to the specific facts and circumstances within the example resulting from the AASB's conclusion that a financial liability should be recognised. ACAG questioned whether there would be a financial instrument, as there does not appear to be another party holding a financial asset (right to receive cash or another financial asset). They noted that a suitable student recipient needs to be selected before there is an obligation to pay cash. Only after the suitable student is selected and agrees to any scholarship terms is there 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 behaviour and achieving suitable grades. Consequently, on receipt of the endowment funds, neither the university's definition of a financial liability or a financial asset of another entity to receive cash from the university is met. Therefore, the definition of a financial instrument is not met.

60 ACAG noted in their feedback that there is support from other stakeholders for treating the receipt of the endowment as a financial liability, based on the future obligation to pay cash to successful students, which may be based on IFRS IC decision on the classification of liability for a prepaid card. However, ACAG also noted that IAS 32 does not require the issuer of a financial liability to identify the specific counterparty with a financial asset when its obligation arises, nor does it require a counterparty to have recognised a corresponding financial asset. They noted that IASB staff in the staff paper discussed by the IFRS IC stipulated that if an entity has a contractual obligation to pay cash, this necessarily means that another party must have a contractual right to receive that cash. ACAG noted that, given that a financial instrument is a contract, identifying those entities that have a right to receive cash should be clear.

61 ACAG also noted that paragraphs 107 and 108 of AASB 15 provide guidance as to why a contract asset is not a financial asset, and this supports the view that on receipt of the endowment, no student or other party has an unconditional right to cash (as a suitable student has not been selected and the scholarship has not been awarded). Also, at the same time, the university does not have an unconditional obligation to pay cash for similar reasons. Therefore, the definition of financial instrument is not met at that time.

Staff analysis and recommendation

62 Staff noted that none of the other respondents explicitly challenged the existence of the financial liability (except the principal versus agent considerations considered in paragraphs 47–58 above).

63 Staff also note that, in the illustrated scenario, the liability is towards the population of the students attending the university, and the condition to be awarded the scholarship is not dissimilar to the condition of the cardholder to use the prepaid card to purchase goods and services in the scenario subject to IFRS IC agenda decision referred to above. Staff also note that the proposed illustrated scenario notes that any remaining principal amount will be returned to the alumnus at the end of the 10-year period, further supporting the right to receive cash.

64 Similar considerations would be relevant for the existing example 3A to the extent applicable, for example, noting that the requirement to return the remaining amount of the principal at the end of the 10-year period, as well as distribution of the scholarships upon the direction of the principal, is not present in the existing example 3A.

65 Whilst, in practice, there may be further conditions associated with the scholarship, such conditions are not included in the illustrative scenario example and therefore are not relevant to the assessment. Staff acknowledge that the scenario may not reflect the most common agreements in practice.

66 However, staff consider that accounting analysis in the existing example 3A can be further clarified by addressing the definition of the financial liability as a contractual obligation to deliver cash to another party. Staff recommend such clarification to be made to the existing example 3A as drafted in Appendix B: Revised amendments to AASB 1058 example 3A given the diverse feedback on the initial recognition and measurement of the financial liability analysed in paragraphs 67–75 below.

Question for Board members

Q7 Do Board members agree with the recommendation in paragraph 66 to clarify in the existing example 3A the considerations to be taken into account when assessing the existence of the financial liability, specifically regarding the definition of the financial liability as a contractual obligation to deliver cash to another party? If not, how would the Board members like to proceed?

Initial recognition and measurement of the financial liability

67 The majority of respondents[17] provided comments and suggestions on several aspects of initial recognition and measurement of the financial liability in the proposed amendment to the example:

17 PwC, KPMG, BDO, Deloitte, EY, ACAG

(a) it is unclear in the proposed example 3A.1 why there is no discounting if the liability is paid over ten years and why the financial asset equals the financial liability on initial recognition;

(b) expand the fact pattern or include clarification that the amounts are payable on demand or whether there is particular timing of the direction of the endowment distribution;

(c) clarify how the conclusion on the financial liability may change if the cash scholarships were not directed and approved by the alumnus annually, and the university has an obligation to use the endowment to fund the scholarships;

(d) reference to paragraph 3.2.15 of AASB 9 is not relevant as the paragraph only applies to transfers that fail the derecognition criteria in para. 3.2.5 of AASB 9 and the pass-through consideration is not relevant to the pattern. Instead, the liability recognition and measurement should reference para. 5.1.1 of AASB 9 and para. 47 of AASB 13;

(e) clarification how the fact that the university can use the income generated by the principal to further its objectives impacts the analysis and would the analysis change if the income must be used for scholarships or in the case of an asset producing no income;

(f) clear articulation of why and how the reference to 'unless another Standards addresses the accounting for the difference, such as the "day one gain/loss" requirements in AASB 9' applies in this case; and

(g) change the example for the university to direct the scholarships and, as the financial liability would not equal the financial asset on initial recognition, the difference to be recognised applying para. B13 of AASB 1058 and para. B5.1.2A(b) of AASB 9.

Staff analysis and recommendation

68 Staff agree that it will be helpful to clarify in the example that the scenario is, in fact, liability on demand, which would explain why there is no discounting for time value of money on initial recognition.

69 Staff consider that extending the example to address the feedback in paragraph 67(c) above would go beyond the intent of the short-term, narrow-scope project to clarify the existing example. Similarly, the scenario suggested in paragraph 67(g) could introduce a complexity from the valuation perspective. Whilst it may be helpful to stakeholders when applying the Standards, the examples do not attempt to illustrate all possible sets of circumstances that may occur in practice. In addition, ED 318 proposed to add an alternative scenario to illustrate the case of immediate income recognition under AASB 1058. Staff also note that the primary aim of the illustrative example is to illustrate the interaction between AASB 1058 and AASB 9 and the identification of related amounts under AASB 9, not to illustrate the application of AASB 9 primarily. Accordingly, staff do not recommend extending or including additional scenarios to address the feedback from stakeholders in this respect.

70 Feedback from stakeholders that the pass-through considerations do not apply are addressed in the section considering comments on principal versus agent considerations above (paragraph 54). Regarding the reference to para. 3.2.15 of AASB 9, staff acknowledge that this paragraph explicitly links to transfers that did not result in the derecognition because the entity has retained substantially all the risks and rewards. Whilst this condition is satisfied in the illustrated scenario, staff agree that the entity applying AASB 9, after determining that the pass-through conditions were not met, would continue to recognise the asset and apply the respective requirements of AASB 9 whether to recognise a financial liability in accordance with para. 5.1.1 of AASB 9. Staff note that a similar example is illustrated in example 5B of AASB 15, including the reference to para. 3.2.15 of AASB 9.

71 If the Board decided to progress with Option 1 identified in paragraph 43, staff recommend to extend the current reference in existing example "Chapter 3 Recognition and derecognition" to include steps for entities to consider in the derecognition process. However, staff do not think it would be appropriate to give a detailed conclusion on the recognition and measurement (including subsequent measurement) of the financial liability given varied feedback on the existing and proposed example. The current scenario in example 3A is not specific enough to provide such details.

72 Staff agree that it would be useful to include further clarification between paras. 10 and B13 of AASB 1058 and paragraphs B5.1.1–B5.1.2A of AASB 9, for example, that paragraph B5.1.1 of AASB 9 notes that "part of the consideration … is for something other than the financial instrument …". Staff think this allocation of the consideration/transaction price between the financial asset and "something other" is essential when subsequently considering application of B5.1.2A of AASB 9 which the refers to the difference between the fair value and transaction price of the financial instrument. However, staff think that such detailed clarification in the Board's pronouncement should not primarily occur in the illustrative example but the Board should have first opportunity to consider whether the clarification is needed in the mandatory part of the Standard. Therefore, staff do not recommend including further detailed assessment beyond clarification in the proposed ED, which referenced paragraph 10 of AASB 1058 (and removed the note that paragraph 10 of AASB 1058 does not apply) and referenced AASB 9 similarly to paragraph B13 of AASB 1058.

73 Staff note that the income from the endowment being available for the university to further its objective in the proposed example 3A.1 supports the conclusion that the university is in the role of the principal as it is entitled to the benefit from the asset. Staff agree with stakeholder feedback that the assessment of this fact could be clarified in the example if the Board decides to progress with the proposals in ED 318. In respect of the suggestions to consider whether conclusions would change in other circumstances noted in paragraph 67(e), the staff do not recommend addressing this feedback as this would extend the scope of the originally intended clarification of the existing scenario into multiple additional scenarios and examples.

74 Accordingly, if the Board decides to progress with Option 2 identified in paragraph 43, it would be useful to clarify that the financial liability is indeed liability on demand and refer to the application of paragraph 5.1.1 of AASB 9 in respect of initial recognition of the financial liability. Similarly, clarifying how the fact pattern relates to the income from the endowment relevant to the analysis (i.e. to support the assessment of the university as the principal in the arrangement) would enhance the example.

75 However, given the varied feedback how to amend the scenario in example 3A when illustrating the recognition and measurement of financial liability, staff recommend to extend the current reference "Chapter 3 'Recognition and derecognition" in the existing example 3A to include illustration of steps for entities to consider in the derecognition assessment as drafted in Appendix B: Revised amendments to AASB 1058 example 3A.

Question for Board members

Q8 Do Board members agree with the recommendation in paragraph 75 to extend the current reference "Chapter 3 'Recognition and derecognition'" in existing example 3A to include steps for entities to consider in the derecognition assessment? If not, how would the Board members like to proceed?

Subsequent measurement and derecognition of the financial liability

76 Some respondents[18] provided the following feedback on subsequent measurement and derecognition of the financial liability[19]:

(a) the amendments are deficient in that they do not address that the settlement of cash scholarship liabilities do not give rise to income; and

(b) the proposed examples do not adequately address the key concern of NFP entities being the subsequent accounting for the financial liability and related income.

Staff analysis and recommendation

77 Staff note that the amended example illustrates that income generated by the principal is recognised according to AASB 9. Staff also acknowledge that the example does not explicitly illustrate the accounting for derecognition of the financial liability (i.e. extinguishment when discharged through the payments). However, it already noted that the financial liability is accounted for AASB 9.

78 Staff considered whether it is necessary to add reference to the requirements of AASB 9 in respect of the liability derecognition outlined in section 3.3 of AASB 9, including that a financial liability is derecognised when it is extinguished. That is, it is discharged or cancelled or expires, and noting that the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

79 Staff considered that the feedback on the illustration of the subsequent accounting of the financial liability is linked with the concerns on the principal versus agent assessment and based on the feedback staff do not recommend to provide further detail on the accounting for financial liability in the proposed example in ED 318 recognising stakeholders's suggestion to focus the illustration on the principal versus agent aspects in first instance.

80 However, staff consider that high-level overview of financial liability derecognition considerations would enhance the existing example 3A, including the conclusion that the settlement of the liability would not have profit or loss impact unless there is difference between carrying amount and consideration paid as drafted in Appendix B: Revised amendments to AASB 1058 example 3A.

Question for Board members

Q9 Do Board members agree with the recommendation in paragraph 80 to include a high-level overview of financial liability derecognition considerations to enhance the existing example 3A including the conclusion that the settlement of the liability would not have profit or loss impact unless there is difference between carrying amount and consideration paid? If not, how would the Board members like to proceed?

Clarification of the use of income and principal towards the NFP objectives in example 3A.2

81 The ACNC noted that example 3A.2 is unclear about which facts from the introduction to example 3 remain and which have been replaced. They also asked for clarification whether:

18 Nexia, Deloitte

19 These comments are linked to the comments around principal versus agent considerations considered in paragraphs 47–58

(a) if there is a requirement to reinvest the income generated by the endowment, how can the university use that income to further its objectives; and

(b) if there is no requirement to apply the principal towards cash scholarships at the direction of alumni, does this mean the university can use the principal to further its objectives?

82 ACAG also recommended amending the proposed example 3A.2 to include the alternate scenario where the university has the discretion to determine the scholarship payments because it is already clear in the Standards and other illustrative examples that an endowment provided for such broad purpose as furtherance of the NFP entity objectives would be recognised as income on receipt.

83 Similarly, Deloitte pointed out that the example would be more helpful if it included more complexities to draw out judgemental implementation issues, such as additional terms in respect of interest income, an administrative fee charge and donation of the funds to a university foundation to be passed onto the college in order to focus the example on the principal versus agent assessment.

Staff analysis and recommendation

84 Staff agree that editorial change to the proposed example 3A.2 to clarify which facts remain unchanged from the base scenario would be helpful.

85 Staff note that the reinvestment, for example, can be in the form of income generating assets such as investments which in turn can provide income to further university objectives. Staff do not think that it needs clarification that the principal can be used to further the university objectives as this already noted in the fact pattern and the question of whether the consideration for an asset is less than fair value principally to enable the entity to further its objectives is addressed in paras. B3 and B4 of AASB 1058.

86 Regarding the suggestions to consider whether conclusions would change in other circumstances as suggested in paragraphs 82 and 83, the staff do not recommend reflecting this feedback as this would extend the scope of the example into multiple additional scenarios.

87 If the Board decides to proceed with ED 318 proposals, it will be appropriate to incorporate editorial change to the proposed example 3A.2 to clarify which facts remain unchanged from the base scenario to the proposed example 3A.2.

88 However, recognising the feedback that the scenario illustrated in proposed example 3A.2 is not as helpful and noting that alternative proposed scenarios would extend the scope and timelines of the project, staff do not recommend proceeding further with proposed example 3A.2.

Question for Board members

Q10 Do Board members agree with the recommendation in paragraph 88 not to proceed further with proposed example 3A.2? If not, how would the Board members like to proceed?

Examples 3B, 3C and other illustrative examples in AASB 1058 and AASB 15

89 ACAG noted that it is not clear whether the AASB intends to retain examples 3B and 3C (based on facts in the existing example 3A) without amendment and suggested that any significant intended changes to these examples be exposed publicly. They also suggested reviewing example 3C for consistency with paras. 73–75 and F32 of AASB 15 because the example separates the income component, even though the requirements for separation do

not appear to be met as there is only one performance obligation and there is no separately identifiable donation component.

90 ACAG also noted that there are similar facts and circumstances included in other existing examples in Appendix F of AASB 15 and in AASB 1058 where unspent funding received must be returned to the grantor, and the conclusion does not result in the recognition of a financial liability. ACAG believes that a financial liability should not be recognised in these existing examples unless/until a breach of the conditions has occurred or is expected. The examples identified are Appendix F, examples 2, 4 and 5 of AASB 15, and examples 6A, 7D, 8A, 9 and 11 of AASB 1058.

Staff analysis and recommendation

91 Staff agree that, depending on the amendments to example 3, there may be a need to clarify further and explicitly specify which facts from the scenario apply to example 3B. However, staff do not recommend amending the substance and outcomes of example 3B. Staff, therefore, do not think any re-exposure would be necessary if the changes are limited to ensuring that the fact pattern in example 3B remains intact.

92 Staff note that example 3C concludes that contract liability is recognised in accordance with paragraph 106 of AASB 15 and that income recognised immediately in profit or loss is for any excess of the fair value of the cash transferred ($2 million) over that contract liability. Staff also noted that the example concludes that AASB 1058 does not apply as the consideration is solely performance obligation within the scope of AASB 15. Staff acknowledge that it would be helpful to clarify how the contract liability was measured at initial recognition and whether the difference recognised in profit or loss represents the time value of money or something else. However, staff note that no other respondents raised this matter and, therefore, the concern the stakeholder raised does not appear to be common.

93 In respect of the other examples, the stakeholder pointed out in relation to the non-recognition of the financial liability, staff note that:

(a) Examples 2 and 4 in AASB 15 and example 7D in AASB 1058 – the scenarios illustrated in the examples result in the agreements being within the scope of AASB 15 with the consideration fully allocated to the performance obligations to deliver goods or services. This is different to the example 3, where the agreement is in the scope of AASB 1058 and therefore requires identification of related amounts, including those in accordance with AASB 9.

(b) Examples 5A and 5B in AASB 1058 – illustrate agreements in the scope of AASB 1058. Example 5A does not conclude whether the financial liability arises on initial recognition. However, example 5B concludes that the financial liability is recognised.

(c) Examples 6A and 8A in AASB 1058 – staff note that example 6A concludes that there is no financial liability for the potential breach of contract as the charity has discretion not to spend money before the specified date in future. Example 8A stipulates that the grant is funding a service delivery (education programs), in contrast with example 3A, which stipulates passing on cash scholarships, and is already noted in paragraph IE3 of AASB 1058 immediately preceding example 3A. Staff also note that the proposed amendments to example 3A result in the financial liability on demand, which is not the case in examples 6A and 8A. However, staff acknowledge that it would require further analysis and consideration of the implication of the proposed amendments to example 3A on example 6A, focusing on assessing whether and when the contractual obligation to deliver cash to another party arises. Staff think such matter should be addressed by the PIR as it may include consideration of the scope of applicable accounting Standards, including AASB 1058.

(d) Examples 9 and 11 in AASB 1058 – example 9 is a 'capital grant' scenario. Para. 16 of AASB 1058 requires recognition of a liability after any related amounts are recognised and stipulates that the grant is to be used to construct a recognisable non-financial asset instead of the obligation to deliver cash to another party. Similarly, example 11 illustrates a grant to fund research to develop intellectual property.

94 Staff acknowledge that the assessment of whether and when the obligation to deliver cash arises requires judgement if the contract is the scope of AASB 1058. Ultimately, any goods, services and assets acquired or delivered in line with the contract may require an outlay of cash. However, notably, these goods, services and assets may also be delivered through other means other than cash outlay (e.g. volunteer/unpaid services). They, therefore, may not necessarily result in the transfer of cash or financial asset.

95 Therefore, staff recommend that, in response to the feedback summarised in paragraphs 89 and 90, no changes to the examples are made other than editorial clarification to ensure the scenario in example 3B remains intact if needed to defer the wider review of existing illustrative examples to the PIR.

Question for Board members

Q11 Do Board members agree with the recommendation in paragraph 95 that no changes to the other examples are made other than editorial clarification to ensure the scenario in example 3B remains intact if needed and to defer the wider review of existing illustrative examples to the PIR? If not, how would the Board members like to proceed?

Other drafting and editorial comments

96 Some stakeholders noted several other comments, including editorial changes required in respect of proposed AASB 1058 illustrative examples in ED 318:

(a) the word 'for' in the second sentence of the accounting treatment section on page 11 should not be deleted (ACNC);

(b) the text in example 3A.2 may be confusing, because the example title says 'income under AASB 1058', but the accounting treatment section says 'as income immediately in profit or loss on recognition of the financial asset in accordance with AASB 9' (ACNC); and

(c) it should be clarified that the NFP should not recognise income on a gross basis if the financial liability is recognised and respective journal entries should be added for clarity on interest income, accretion of the liability and disbursement of scholarships (PwC, ACAG, KPMG, BDO, HoTARAC),

Staff analysis and recommendation

97 Staff agree with the editorial change in paragraph 96(a). In respect of the feedback noted in paragraph 96(b), staff agree the example 3A.2 should clarify that no related amount is recognised in accordance with AASB 9 or other Standards to avoid potential confusion that income is recognised under AASB 9, rather than AASB 1058.

98 Based on the varied feedback on the existing example 3A and proposed example 3A.1 as well as given the current scenario is not specific enough to provide such details as discussed in paragraph 71, staff do not recommend to include further details on the accounting for the financial liability such as the journal entries other than high-level overview overview of financial liability derecognition considerations as recommended in paragraph 80 .

99 Staff recommend that the proposed amendments in the "Accounting treatment" section in the first paragraph on page 11 of ED 318 are incorporated into the existing example 3A as drafted in Appendix B: Revised amendments to AASB 1058 example 3A.

Question for Board members

Q12 Do Board members agree with the recommendation in paragraphs 98 and 99, that the proposed amendments in section "Accounting treatment" in the first paragraph on page 11 of ED 318 are incorporated into the existing example 3A? If not, how would the Board members like to proceed?

Part C – Concessionary leases

100 As noted in paragraph 17, almost all respondents agreed with the proposal in respect of ROU assets arising from concessionary leases of NFP private sector entities that the current accounting policy choice should be retained on an ongoing basis and the current disclosures are sufficient (nine agreed and one did not comment).

101 Relating to the proposal in respect of disclosures for ROU assets arising from concessionary leases of NFP public sector entities, all ten respondents agreed that disclosures are sufficient. However, one respondent (HoTARAC) urged the AASB to afford the public sector NFP reporters the same relief regarding the initial measurement of ROU assets arising from concessionary leases, at the same time as for the NFP private sector entities. This feedback is analysed in further detail below.

Concessionary leases (not-for-profit public sector lessees)

102 HoTARAC disagreed with the decision to defer a decision regarding NFP public sector ROU assets arising from concessionary leases as the optional treatment, made permanent for the NFP private sector, should equally be made permanent to the NFP public sector reporters at the same time, on the following basis:

(a) Since adopting AASB 1058 and AASB 16 *Leases* from 1 July 2019, public sector reporters have availed themselves of the relief afforded under AASB 2018-8. No apparent information gap arose by reporting ROU assets under concessionary leases at cost. The benefit of having fair value information about concessionary leases to public sector financial statements users is questionable, considering the complexity and potential future cost involved in determining fair values for these ROU assets.

(b) The IPSASB leases project, and its related concessionary leases consideration is ongoing. Although this project may provide a useful reference point in the future, public sector NFP reporters also require certainty (like their private sector counterparts) in the short term for budgeting, accountability and future policy purposes. Even if the IPSASB direction is significantly different to the existing one adopted by the AASB, HoTARAC believes that certainty of treatment is more imperative than comparability with IPSASB reporters.

(c) HoTARAC had previously indicated to the AASB that the number of arrangements, the relative informal documentation supporting these arrangements and the practicality of enforceability within the sector would make the removal of the optional relief from recording ROU assets under concessionary leases at fair value too costly and time consuming, when compared to the benefit.

Staff analysis and recommendation

103 Staff highlight that the Board noted concerns raised by public sector stakeholders regarding the difficulty of measuring the fair value of historical concessionary leases when developing ED 318 proposals. After this consideration, however, the Board decided not to propose grandfathering concessionary leases currently in place from a possible future fair value requirement unless the Board decides to remove the accounting policy choice to initially measure ROU assets arising under concessionary leases at cost.

104 Staff note that the stakeholders' feedback does not provide new significant information beyond the information provided in staff paper 11.2 *Initial measurement of the right of use assets under concessionary leases* presented at the November 2021 AASB meeting. That staff paper noted why the decision about initial measurement of new concessionary leases should be deferred until the Board decides whether additional guidance on how to measure the fair value of such assets. The reasons include:

(a) whilst public sector entities have knowledge and experience in applying AASB 13 principles in measuring the fair value of other non-financial assets, the additional guidance might still be necessary to help reduce cost and effort in estimating the fair value of concessionary ROU assets, particularly leases with restrictions or leases of specialised assets;

(b) if the Board decides to issue such additional guidance, and if it agrees with grandfathering existing concessionary leases from the fair value requirement, the cost to obtain fair value measurements of ROU assets of new concessionary leases might not be significant because lessees would be able to ensure the necessary terms and conditions are appropriately documented in the lease agreement of any new concessionary leases; and

(c) some lessors might be another public sector entity. Consequently, the NFP public sector lessee would likely be able to obtain fair value information about the lease asset from the lessor, which may assist in measuring the fair value of the associated ROU asset.

105 Staff consider the reasons that the Board considered when making ED 318 are still relevant. Accordingly, staff recommend to proceed with proposals as exposed in ED 318 and do not recommend to amend the proposals in respect of public sector ROU assets from concessionary leases.

Questions for Board members

Q13 Do Board members agree with the recommendation in paragraph 105 to proceed with proposals as exposed in ED 318 and not to amend the proposals in respect of public sector ROU assets from concessionary leases? If not, how would Board members like to proceed?

Next Steps

Due process

106 Subject to the Board's decisions with respect to Questions 1–13 above, staff considered whether the amendments can be finalised or whether they should be reexposed either through a new consultation process (see paragraph 7.7.1) or through a "fatal flaw" limited exposure.

107 After consideration of the requirements of the AASB Due Process Framework para. 7.7.1 considering criteria for re-exposure such as the extent of new substantive issues, the extent of change to original proposals, the extent of input from stakeholders and any new evidence on the extent and nature of the issue, staff think that the issuance of the final proposals for public comment is warranted in respect of changes to example 3A in AASB 1058 despite the amendments relate to non-mandatory part of the Standard.

108 Staff recommend re-exposure through a fatal-flaw review draft after considering requirements of para. 7.6.7 of Due Process Framework to provide a short period for public comment to identify any unintended consequences of the proposals. Staff note that the minimum comment period for a fatal-flaw review draft is two weeks (para. 6.5(d) of Due Process Framework).

Question for Board members

Q14 Do Board members agree with the recommendation to issue a fatal-flaw review draft with a comment period of two weeks? If not, how would the Board members like to proceed?

109 Subject to Board members' agreement with the staff recommendations in this paper, staff recommend following next steps, including issuing a fatal-flaw review draft for public comment and subsequently proceeding to the ballot version draft version of an Amending Standard for voting. Therefore, staff suggest the following timeline:

Staff to prepare a ballot draft version of the Fatal-Flaw Review Draft for consideration by the Board subcommitee members out-of-session (two-week comment period).	Week commencing 11 April 2022
The Board subcommittee members' approval of the ballot draft version of the Fatal-Flaw Review Draft are due.	Week commencing 25 April 2022
Staff to finalise issue the Fatal-Flaw Review Draft with two-week comment period.	Week commencing 2 May 2022
Staff to consider stakeholder feedback on the Fatal-Flaw Review Draft	Week commencing 23 May 2022
Staff to circulate a ballot draft version of the Amending Standard for out-of-session voting (one-week voting period).	Week commencing 30 May 2022
Votes on the ballot draft version of the Amending Standard are due.	Week commencing 6 June 2022
Staff to finalise and issue the Amending Standard.	Week commencing 13 June 2022

Questions for Board members

Q15 Do Board members agree with the staff recommendation in paragraph 109 to prepare a ballot draft version of the Fatal-Flaw Review Draft for approval with two-week comment period?

Q16 Do Board members agree for the Board subcommittee to approve the Fatal-Flaw Review Draft out of session?

Q17 Do Board members have any other comments on the suggested next steps and timeline?

Appendix A: Revised amendments to AASB 15 example 7A

IE4A Example 7A illustrates application of the requirements of AASB 15 to transactions where a not-for-profit entity charges upfront fees to customers or members as part of the goods and services offered. The following are examples of upfront fees:

(a) joining fees at clubs and membership bodies;

(b) enrolment fees at schools; and

(c) other establishment or set-up fees where the fee is paid at or near contract inception and the customer can renew the contract each year without paying an additional fee.

Where the goods or services to which the upfront fee relates are in the scope of AASB 15, the recognition of the upfront fee as revenue depends on whether the payment of the fee relates to a transfer of distinct goods or services to the customer that meets the definition of a performance obligation. In many cases, even though a non-refundable upfront fee relates to the activity that an entity is required to undertake to fulfil the contract, that activity may be an administrative task that does not necessarily result in the transfer of a promised good or service to the customer.

Example 7A—Upfront fee charged by an organisation

An organisation offers enrolment to prospective clients for the services it provides. Upon accepting an offer of enrolment, the prospective client must pay an upfront fee (sometimes referred to as an 'acceptance fee', 'entry fee' or 'enrolment fee'). The enrolment form sets out the following terms and conditions relevant to the fee:

- upon payment of the fee, future service is guaranteed for the client to commence in the agreed-upon year and ~~for the period of the contract, being 2 years;~~<u>on an ongoing basis.</u>
- the fee is non-refundable and non-transferable; and
- the fee is not offset against any future fees that are charged on an ongoing basis for continued access to the services.

The analysis below sets out the process followed by not-for-profit entities in determining the accounting treatment for upfront fees charged. The process does not specifically discuss any particular fee and is applied in the context of the relevant facts and circumstances of an entity's upfront fees. Note: the term customer is used in the analysis to cover all counterparties to an agreement, for example members or students.

<u>Analysis</u>

Is the contract within the scope of AASB 15 Revenue from Contracts with Customers*?*

The entity first considers whether the agreement with the customer is within the scope of AASB 15, by referring to AASB 15 paragraphs 9–21 and F5–F19 to determine whether there is a contract with a customer:

- Is there a customer who has promised consideration in exchange for goods or services from the entity and is the promise to transfer goods or services sufficiently specific? (AASB 15, paragraphs 9, Aus9.1 and F5–F7)
- Is there a written, oral or implied agreement, such as an application form or other document? (AASB 15, paragraphs 10 and F8–F9)
- Does the agreement create enforceable rights and obligations for the parties? For example, could the customer either enforce the agreement or obtain other remedy under Australian law if the promised service was not delivered? (AASB 15, paragraphs 10 and F10–F18).

In many cases where there will be an ongoing relationship with the customer following payment of the upfront fee, such as annual fees to access a service, revenue would be recognised in accordance with AASB 15. If multiple agreements are in place, for example an agreement for a joining fee and a separate agreement for the annual membership fee, then the guidance in paragraph 17 of AASB 15 should be considered in relation to combining the agreements for accounting purposes.

What are the performance obligations in the contract, and are the activities associated with the non-refundable upfront fee one of these performance obligations?

The entity considers the guidance on:

- accounting for non-refundable fees in AASB 15, paragraphs B48–B51; and
- identifying performance obligations in AASB 15, paragraphs 22–30 and F20–F27;

to determine whether the upfront fee relates to the transfer of a good or service separate to the provision of services in the future.

In performing this analysis, the entity notes that performance obligations do not include activities that an entity must undertake to fulfil a contract (e.g. setting up a customer on the system, printing membership cards and similar) unless those activities transfer a good or service to the customer (AASB 15, paragraph 25). The non-refundable fee might cover internal administrative activities that enable the entity to provide future services to the customer. However, these activities do not transfer a promised good or service to the customer separate from the provision of future services and ~~are~~ therefore do not satisfy ~~not~~ a separate performance obligation (AASB 15, paragraph B~~49~~51). If this is the case, the entity concludes that the non-refundable upfront fee – to the extent it relates to the internal administrative services – does not represent a payment for a separate performance obligation but is in substance an advance payment for future services.

In other circumstances, some or all of the upfront fee may relate to a separate performance obligation or obligations, whether satisfied at or near contract inception or otherwise.

How is the revenue for the upfront fee recognised?

Where the activity does not result in a transfer of a good or service to the customer that satisfies a separate performance obligation and the upfront fee is an advance payment for performance obligations to be satisfied in the future, the upfront fee is recognised as revenue as these future services are provided, that is, over the period in which the performance obligation is satisfied. If the entity has charged the non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks) and those setup activities are not a separate performance obligation, they should be disregarded when measuring progress towards completion of the services (AASB 15, paragraph B51). The revenue recognition period will extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right (e.g. no requirement to pay a further joining fee on renewal) (AASB 15, paragraphs B40 and B49). Annual fees charged to access the services will be recognised as revenue over the period that the services are provided.

In the circumstances where some or all of the upfront fee relates to a separate performance obligation or obligations, the relevant portion of the upfront fee is recognised as revenue when the separate performance obligations are satisfied.

Accounting treatment

The organisation applies AASB 15 paragraphs 9–21 and F5–F19 and concludes that the agreement is within the scope of AASB 15, as:

- there is a customer – the client – who has promised consideration in exchange for future services (an ordinary activity of the organisation) to be provided to a specified recipient (~~see~~AASB 15, paragraphs 6 and F6–F7); and
- a contract exists, as there is a written agreement (~~see~~AASB 15, paragraphs 10 and F8–F9) that creates enforceable rights and obligations for the client to receive services in the agreed-upon years. Despite the fee being non-refundable, the client ~~would~~ could either enforce the agreement or obtain remedy under Australian law if the organisation did not provide services in the agreed-upon years (~~see~~AASB 15, paragraphs 10 and F10–F18).

The organisation considers the guidance on accounting for non-refundable fees in AASB 15 paragraphs B48–B51 and refers to paragraphs 22–30 and F20–F27 to assess whether the upfront fee relates to the transfer of a good or service separate to the provision of services in the future.

The organisation concludes that the non-refundable upfront fee does not relate to an activity that represents a separate performance obligation (see paragraph 25), therefore the fee is included in the consideration for the performance obligation(s) in the agreement (to provide future services). ~~, but is instead an advance payment for future services. Therefore, t~~The upfront fee is treated as an advance payment for future services and is recognised as revenue ~~as the future services are provided over the two-year contract period~~ over the period of ongoing services. (see paragraphs 30 and B49).

Appendix B: Revised amendments to AASB 1058 example 3A

An alumnus transferred $2 million cash to University A as an endowment. Under the terms of the endowment:

- the $2 million cash can be invested at the university's discretion;
- subject to preserving the real value of the principal, all income generated from investing the principal is required to be applied towards cash scholarships of $20,000 per student for the student to use at their discretion; and
- if the university breaches the terms of the endowment, the university is required to return the real value of the principal to the alumnus.

Scope and asset recognition

University A determines:

- it has an enforceable agreement with the alumnus, as the university can be required to return the endowment in the event it breaches the terms under which it was given;
- the $2 million endowment is an asset the university acquired for no consideration to further the objectives of the university. Accordingly, the endowment is within the scope of AASB 1058; and
- it controls a financial asset ($2 million) within the scope of AASB 9 and it recognises the financial asset for the endowment received in accordance with the requirements of paragraph 3.1.1 of AASB 9. This follows university's consideration whether it became party to the contractual provisions of the financial instrument and whether it controls the financial asset, for example whether it has the legal right to the asset and whether it controls the benefits from the asset.

Example 3A – Financial instrument (cash scholarships, not goods or services)

Based on the facts and circumstances outlined above, as the income generated from the principal amount (excluding the income required to preserve the real value of the principal) must be applied towards funding cash scholarships at some time in the future (at its discretion), the university considers whether it should recognised a financial instrument (i.e. whether it has incurred a financial liability under AASB 9 as a related amount in accordance with paragraph 3.1.1 of AASB 9). University considers whether it has a contractual obligation to deliver cash to another party and whether it does not not have an unconditional right to avoid delivering cash to settle this contractual obligation in accordance with AASB 132 .

The university also considers whether derecognition of the financial asset is appropriate under Chapter 3 'Recognition and derecognition' of AASB 9, instead of the recognition of a financial liability. As the univeristy agreed to apply the endowment towards cash scholarships, the university considers whether it has transferred the financial asset to scholarship recipients. When making such assessment, the university considers whether it had transferred the contractual right to receive the cash flows from the financial asset or whether it retained the contractual rights to receive those cash flows but assumed a contractual obligation to pay the cash flows in the arrangement that meets requirements of paragraph 3.2.5 of AASB 9 (i.e. whether it had entered a 'pass-through arrangement'). Depending on the outcome of this assessment, the university then considers other requirements of Chapter 3 'Recognition and derecognition' of AASB 9.

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 1058.

Similarly, the endowment does not give rise to the following types of related amounts:

- a contribution by owners, as the alumnus does not control or have an ownership interest in the university;
- a lease liability as defined in AASB 16, as the endowment does not provide a right to use a specified asset; and
- a provision within the scope of AASB 137, as the agreement provides legal obligations and there are no other constructive obligations that are sufficiently specific to consider.

Accounting treatment

In accordance with paragraph 9, University A accounts for the endowment under AASB 9. In accordance with paragraph B13, any difference between the fair value of the asset recognised and the consideration paid for the asset after deducting any other related amounts (being the difference between the $2 million financial asset recognised and a related financial liability recognised would be accounted for ~~under AASB 9~~ as income in accordance with paragraph 10, unless another Standard addresses the accounting for the difference, such as the "day one gain/loss" requirements in AASB 9. ~~Paragraph 10 of AASB 1058 does not apply in this case.~~

University subsequently derecognises any financial liability if either the obligation to deliver cash is discharged, cancelled or expires, for example upon its cash settlement. University recognises any difference between the carrying amount of the financial liability discharged and consideration paid in profit or loss.