Australian Government
Australian Accounting Standards Board

# Staff Paper

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| **Project:** | **Not-for-Profit Private Sector Financial Reporting Framework** | **Meeting:** | M187 |
| **Topic:** | **Supporting document: High-level scenarios and other supporting materials** | **Agenda Item:** | 5.1.3 |
| | | **Date:** | 2 May 2022 |
| **Contact(s):** | Carmen Ridley<br>cridley@aasb.gov.au<br>Maggie Man<br>mman@aasb.gov.au<br>Fridrich Housa<br>fhousa@aasb.gov.au | **Project Priority:**<br>**Decision-Making:**<br>**Project Status:** | High<br>N/A<br>Initial deliberations |

## The objective of this paper

1. The objective of this staff paper is to provide the Board with:

   a) high-level scenarios to illustrate the differences in the outcomes of possible income recognition options presented in Agenda Paper 5.1.1 and Agenda Paper 5.1.2 and

   b) supporting materials including:

      i. **APPENDIX** A: Approach to simplification agreed by the Board at its 4 August 2021 Board meeting; and

      ii. **Appendix B**: Excerpts of superseded AASB 1004 *Contributions*

      iii. **Appendix C**: Excerpts of Basis for Conclusions from AASB 1058 *Income of Not-for-Profit Entities*

2. Table 1 below presents six high-level scenarios to illustrate the differences in the outcomes of possible income recognition options presented in Agenda Paper 5.1.1 and Agenda Paper 5.1.2 accompanied by the staff assessment of scale of difficulty of the application of the identified options below:

| Staff assessment of scale of difficulty of application of the identified options to high-level scenarios |
|---|
| **Simplest option –** immediate income recognition, less record keeping required or no extensive education or training required to apply new requirements. |
| **Moderately simple option -** requires some education or training to apply new requirements or requires more record keeping |
| **Most difficult –**most record keeping required, or management required to assess all transactions |

*Table 1 Application of the identified options to high-level scenarios*

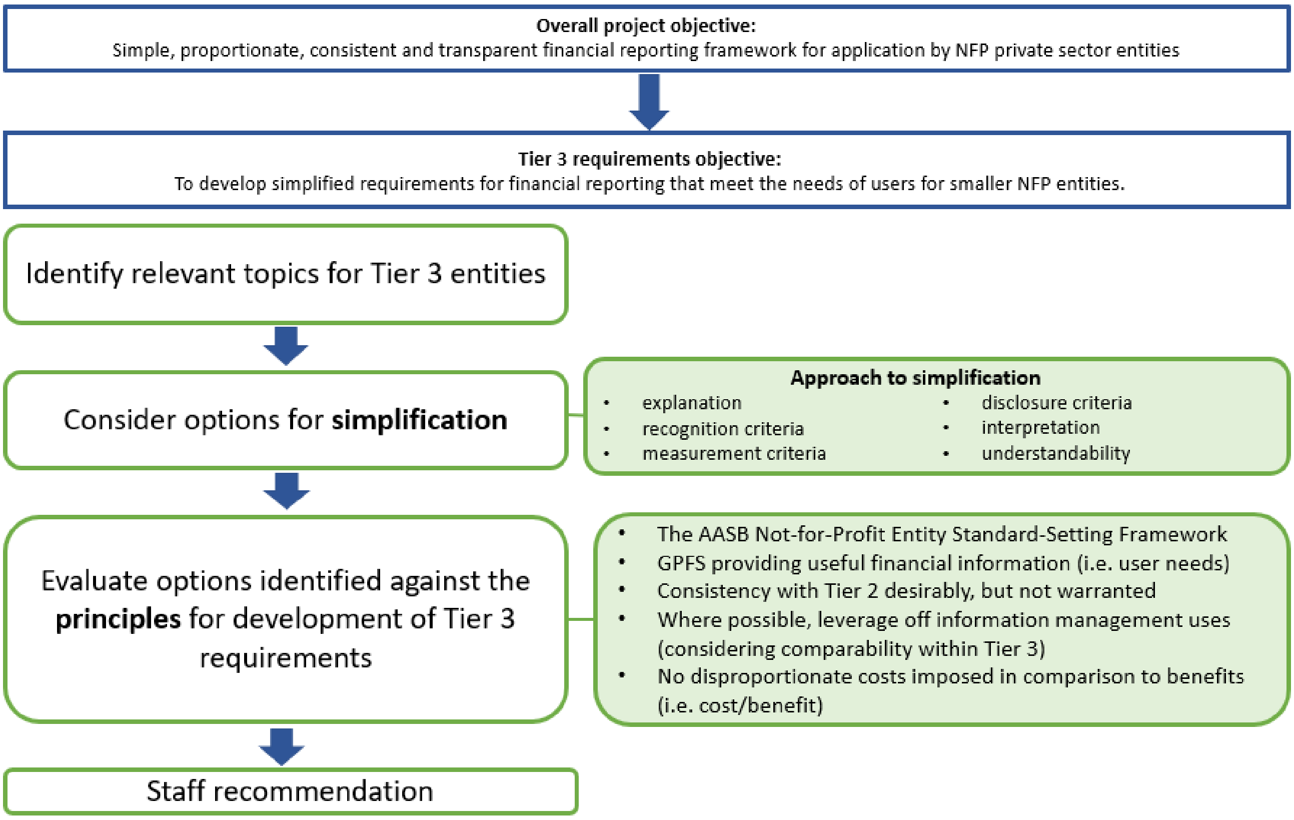
| **Options identified in Agenda Papers 5.1.1 and 5.1.2** | **Application of the identified options to the following scenarios:** | | | | | |
|---|---|---|---|---|---|---|
| | **Sales of goods and/or services** | **Entity receives operational funding in current year to be spent in the following financial year** | **Entity receives funds to employ staff and fund their salaries** | **Entity receives operational funding to further its objectives** | **Entity received funds to construct a non-financial asset** | **Entity receives funds to perform a research activity** |
| **Option 1A**: Existing NZ's model | Recognise **income when sales occur** (usually when goods are received by the purchaser) or when services are provided (stage of completion method) | **If** funding has '**use or return**' condition, income recognise **when expenditure incurred**. Otherwise, income recognised **at the earlier of when** resources received/ receivable | **If** funding has '**use or return**' condition, income recognise **when expenditure incurred**. Otherwise, income recognised **at the earlier of when** resources received/ receivable | **If** funding has '**use or return**' condition, income recognise **when expenditure incurred**. Otherwise, income recognised **at the earlier of when** resources received/ receivable | **If** funding has '**use or return**' condition, income recognise **when expenditure incurred**. Otherwise, income recognised **at the earlier of when** resources received/ receivable | **If** funding has '**use or return**' condition, income recognise **when expenditure incurred**. Otherwise, income recognised **at the earlier of when** resources received/ receivable |

| Options identified in Agenda Papers 5.1.1 and 5.1.2 | Application of the identified options to the following scenarios: | | | | | |
|---|---|---|---|---|---|---|
| | **Sales of goods and/or services** | **Entity receives operational funding in current year to be spent in the following financial year** | **Entity receives funds to employ staff and fund their salaries** | **Entity receives operational funding to further its objectives** | **Entity received funds to construct a non-financial asset** | **Entity receives funds to perform a research activity** |
| **Option 2A**: Expenses/time-based matching model | Recognise income for all inflows of resources **to match** related **expenditure or time** lapse associated with delivery of goods/services. | Recognise income for all inflows of resources and recognise over time to **match expenses or time** lapse | Recognise income for all inflows of resources and recognise over time to **match expenses or time** lapse | Recognise income for all inflows of resources and recognise over time to **match expenses or time** lapse | Recognise income for all inflows of resources and recognise over time to **match expenses or time** lapse | Recognise income for all inflows of resources and recognise over time to **match expenses or time** lapse |
| **Option 2B and Option 3C:** Receipt-based model | **Income recognised at the earlier of when** resources received/ receivable | **Income recognised at the earlier of when** resources received/ receivable | **Income recognised at the earlier of when** resources received/ receivable | **Income recognised at the earlier of when** resources received/ receivable | **Income recognised at the earlier of when** resources received/ receivable | **Income recognised at the earlier of when** resources received/ receivable |
| **Option 2C**: Completion of activities/services model | Income recognised when goods are **delivered,** or services are **rendered**. | Income recognised when funds are **utilised** | Income recognised when funds are **utilised** | Income recognised when funds are **utilised** | Income recognised at construction of non-financial asset is **completed**. | Income recognised when funds are **utilised** |
| **Option 3A**: Enforceable conditions model | **If enforceable** based on refund or other means, then **income** recognise when related liabilities associated with delivery of goods/services are **satisfied**. | **If enforceable** based on refund or other means, then **income** recognise **as expenditure incur**.<br>If **not enforceable**, income recognised **at the earlier of** | **If enforceable** based on refund or other means, then **income** recognise **as expenditure incur**.<br>If **not enforceable**, income recognised **at the earlier of** | As there is no **time stipulation** from transfer provider, income is recognised **at the earlier of when** resources received/ receivable | **If enforceable** based on refund or other means, then income recognised as **expenditure incurred**<br>If **not enforceable**, income recognised **at the earlier of when** resources received/ receivable | **If enforceable** based on refund or other means, then income recognised when **expenditure incurred**.<br>If **not enforceable**, income recognised **at the earlier of when** |

| Options identified in Agenda Papers 5.1.1 and 5.1.2 | **Application of the identified options to the following scenarios:** | | | | | |
|---|---|---|---|---|---|---|
| | **Sales of goods and/or services** | **Entity receives operational funding in current year to be spent in the following financial year** | **Entity receives funds to employ staff and fund their salaries** | **Entity receives operational funding to further its objectives** | **Entity received funds to construct a non-financial asset** | **Entity receives funds to perform a research activity** |
| | If **not enforceable**, income recognised **at the earlier of when** resources received/ receivable | **when** resources received/ receivable | **when** resources received/ receivable | | | resources received/ receivable |
| **Option 3B:**<br>Expenses/time-based matching model only for inflows of resources with explicit stipulation from transfer provider to use the inflows of resources in a particular way | Recognise income for to s **match** related **expenditure or time** lapse associated with delivery of goods/services are **satisfied**. | Recognise income to **match expenses or time** lapse | Recognise income to **match expenses or time** lapse | **Income recognised at the earlier of when** resources received/ receivable | Recognise income to **match expenses or time** lapse | Recognise income to **match expenses or time** lapse |
| **Option 4A**: AASB 15 model where all aspects of Paragraph F20 must be present | Recognise income **when** customer **obtains control** of the promised good or service. | Recognise income to **match expenses or time** lapse | Recognise income to **match expenses or time** lapse | Income recognised **at the earlier of when** resources received/receivable | Recognise income as entity **satisfies** its **obligations** to construct the non-financial asset. | Income recognised **at the earlier of when** resources received/ receivable |

| Options identified in Agenda Papers 5.1.1 and 5.1.2 | Application of the identified options to the following scenarios: | | | | | |
|---|---|---|---|---|---|---|
| | **Sales of goods and/or services** | **Entity receives operational funding in current year to be spent in the following financial year** | **Entity receives funds to employ staff and fund their salaries** | **Entity receives operational funding to further its objectives** | **Entity received funds to construct a non-financial asset** | **Entity receives funds to perform a research activity** |
| **Option 4B**: A rebuttable presumption to recognise all income transactions when cash received/receivable unless AASB 15 is appropriate | Likely to satisfy sufficiently specific criterion and therefore income recognised when customer **obtains control** of promised good or service. | Income recognised **at the earlier of when** resources received/ receivable unless AASB 15 achieves more faithful representation | Income recognised at the **earlier of when** resources received/ receivable unless AASB 15 achieves more faithful representation | Income recognised at the **earlier of when** resources received/receivable unless AASB 15 achieves more faithful representation | Income recognised **at the earlier of when** resources received/ receivable unless AASB 15 achieves more faithful representation | Likely **income recognised at the earlier of when** resources received/receivable unless AASB 15 achieves more faithful representation |

## Appendix A – Approach to simplification agreed by the Board at its 4 August 2021 Board meeting



## Appendix B – Excerpts from superseded AASB 1004 *Contributions*

B1. Prior to the issue of AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities,* not-for-profit (NFP) entities were required to comply with AASB 1004 for the accounting requirements of income arising from contributions of assets. The following is an excerpt from the superseded AASB 1004 applicable to NFP private sector entities.

***Recognition of Contributions of Assets***

12. *Income arising from the contribution of an asset to the entity shall be recognised when, and only when, all the following conditions have been satisfied:*
    a) *the entity obtains control of the contribution or the right to receive the contribution;*
    b) *it is probable that the economic benefits comprising the contribution will flow to the entity; and*
    c) *the amount of the contribution can be measured reliably.*

13. *A contribution occurs when an entity receives an asset, including the right to receive cash or other forms of asset without directly giving approximately equal value to the other party or parties to the transfer; that is, when there is a non-reciprocal transfer. Contributions would, for example, include donated assets. Contributions that are income exclude contributions by owners.*

14. *In some cases it may be difficult to determine whether the entity has control of a contribution or the right to receive a contribution. One such case could be economic benefits expected to be received under a multi-year public policy agreement. The entity does not obtain control of a contribution under such an agreement until it has met conditions or provided services or facilities that make it eligible to receive a contribution. On this basis, under multi-year public policy agreements, income would be recognised only in relation to contributions received or receivable under policy agreements. Another example is where a donor pledges a donation to an entity. If the pledge is not enforceable against the donor, the entity does not control the contribution.*

15. *In some cases it may be difficult to determine whether the entity is giving approximately equal value to the other parties to a transfer. This is particularly the case where, for example, fees are charged by a not-for-profit entity for the potential use of a general pool of facilities. In circumstances where clubs and professional associations charge fees in return for contributors being able to enjoy the use of facilities, receive publications or practice in a particular vocation for a defined period, an exchange transaction can be presumed and the fees would not be treated as contributions. The recipient of the fees would have a contractual or constructive obligation to refund some or all fees if it were unable to provide the facilities or services. In circumstances where the benefits to contributors are only nominal, such as acknowledgment letters, general information about the entity's activities and satisfaction of contributors' altruistic goals, the fees are in the nature of contributions.*

***Liabilities Forgiven***

16. *The gross amount of a liability forgiven by a credit provider shall be recognised by the borrower as income.*

17. *Where equity is substituted for a liability, this is not treated as a forgiveness.*

## Appendix C – Excerpts of Basis for Conclusions from AASB 1058 *Income of Not-for-Profit Entities*

C1. The following is an excerpt from the Basis for Conclusions in AASB 1058 regarding the need for change to address the issues with identifying whether a transaction was reciprocal or non-reciprocal under superseded AASB 1004.

***The need for change***

*BC2 Prior to the issue of this Standard and AASB 15 Revenue from Contracts with Customers, the recognition and measurement requirements for transactions giving rise to income depended on whether the transaction was reciprocal or non-reciprocal in nature. The accounting for income arising from reciprocal transactions was predominantly addressed in AASB 118 Revenue and AASB 111 Construction Contracts. The accounting for income arising from non-reciprocal transactions was addressed in AASB 1004 Contributions.*

*BC3 The Board observed determining whether a transaction was reciprocal or non-reciprocal in practice was not always straightforward. Entities found it challenging to determine whether approximately equal value had been provided in exchange to the other party or parties to the transfer, and contended that in many instances the immediate recognition of income in a non-reciprocal transaction did not faithfully represent the underlying financial performance of the entity. Diverse interpretations existed, with some entities recognising transactions with return obligations and specified performance outcomes as reciprocal transactions and some not.*

*BC4 Constituents were particularly concerned about the income recognition requirements as applied to grants, appropriations and other transfers of assets made on the condition that the not-for-profit entity deliver goods or services to nominated third parties. The Board heard that constituents who are preparers find it difficult to discuss financial information with grantors and donors, and challenging to explain why a not-for-profit entity needed additional resources when the financial statements indicated no such need. Users noted they did not think the financial statements were reflective of the economic reality of a not-for-profit entity's financial circumstances. Having regard to the feedback from constituents, the Board decided to undertake a project to conduct a fundamental review of the income recognition requirements applying to not-for-profit entities.*

*BC5 The Board observed that the International Accounting Standards Board had completed developments in the accounting for revenue with the issue of IFRS 15 Revenue from Contracts with Customers in May 2014. The Board noted it still needed to determine what, if any, amendments and guidance would be required to enable not-for-profit entities to apply the equivalent Australian Accounting Standard, AASB 15. In addition, the Board noted that the application of the performance obligation approach to revenue recognition adopted in AASB 15, using a broader concept of customer, had the potential to resolve some of the issues noted with AASB 1004. Consequently, the Board considered that this was an appropriate time to undertake a project to review the income recognition requirements applying to not-for-profit entities*

*BC6 As part of its current project, the Board noted there is currently divergence in practice in the accounting for leases with significantly below-market terms and conditions, such as 'peppercorn' leases where a nominal amount is made as payment to the lessor. Some entities consider AASB 117 Leases takes precedence over AASB 1004 and accordingly, currently recognise such leases at nominal values; others consider the reverse applies and recognise such leases at fair value, together with a related contribution. The Board decided its project should also clarify the accounting for such leases.*

BC7 *The Board also observed that various Australian Accounting Standards required a not-for-profit entity to recognise assets received at fair value (or current replacement cost, in relation to inventories) only where the asset had been acquired for no or nominal consideration (for example, AASB 116 Property, Plant and Equipment and AASB 138 Intangible Assets). The Board perceived there to be a gap in the accounting for those transactions where an asset has been acquired for consideration that is below market but is more than nominal. The Board noted that under existing recognition and measurement rules at that time, an entity would likely not have recognised any income on the transaction, but measured the asset acquired at the amount of the consideration transferred. The Board considered that, in many instances, such transactions were unlikely to be conceptually different to those for which no consideration was transferred, and consequently decided to also consider the accounting for such transactions as part of this project.*

*…*

BC11 *The Board decided not to develop proposals based on the accounting specified by AASB 1004 (as in force at that time), having regard to constituent feedback leading to the Board undertaking the project. In addition, the Board observed that the approach in AASB 1004 does not acknowledge that a non-reciprocal transfer may be made on terms and conditions representative of a liability as defined in the Framework for the Preparation and Presentation of Financial Statements.*