Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M187
Topic:	**Tier 3 – Revenue/Income – determining the distinction for the accounting for inflows of resources**	**Agenda Item:**	5.1.1
		Date:	2 May 2022
Contact(s):	Maggie Man mman@aasb.gov.au Carmen Ridley cridley@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Project Priority:** **Decision-Making:** **Project Status:**	High High Initial deliberations

The objective of this paper

1 The objective of this staff paper is for the Board to **decide** its preliminary views, for the purpose of the discussion paper (DP), on Tier 3 reporting requirements for not-for-profit (NFP) private sector entities for inflows of resources to a Tier 3 NFP entity that result in income.[1] This paper will ask the Board to **decide** whether to require a distinction for the accounting for inflows of resources in developing the recognition requirements to apply to all inflows of resources.[2]

Background and reasons for bringing this paper to the Board

2 At its February 2021 meeting, the Board agreed to develop a further reporting Tier (Tier 3) for application by not-for-profit (NFP) private sector entities. Several staff papers have been presented, including the approach to simplification agreed by the Board at its August 2021 Board meeting[3] as shown in Appendix A of Agenda Paper 5.1.3. The Board has made a number of tentative decisions to date in developing the Tier 3 accounting requirements. These decisions are summarised in The Not-for-Profit Private Sector Financial Reporting Framework Project Summary.

Board tentative decisions in developing Tier 3 revenue/income to date

3 At its February 2022 Board meeting, the Board decided that the forthcoming DP should discuss potential options for simplifying income accounting for Tier 3 entities. The Board noted that the feedback from the upcoming post-implementation review (PIR) of AASB 1058 *Income of Not-for-Profit Entities* and NFP guidance to AASB 15 *Revenue from Contracts with Customers* might further assist the deliberations in determining the next steps, including when and how to progress to an Exposure Draft.

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1 In this paper, inflows of resources include both revenue arising from contracts with customers, and transactions where the consideration to acquire an asset is significantly less than fair value principally to enable an NFP entity to further its objectives, except for volunteer services.

2 Agenda Paper 5.1.2 asks the Board to decide whether to require the assessment of 'sufficiently specific' criteria for accounting of inflows of resources with performance obligations if the Board decides to require the distinction for inflows of resources in this staff paper.

3 Refer minutes of the 182nd AASB meeting.

4 The Board also instructed staff at the February 2022 Board meeting to analyse further some of the options for Tier 3 reporting requirements for income from grants, donations and bequests presented in Agenda Paper 11.4 of the February 2022 meeting. In particular:

(a) Option B: the "enforceable conditions model" – recognition of income by identifying liabilities where there are enforceable conditions;

(b) Option C: the "enforceable activities/expenditure model" – recognition of income set out in AASB 1058 by identifying liabilities for obligations that are not owed to customers, including performing specified activities or incurring eligible expenditure. The Board directed staff to analyse this option further to factor in cases when a stipulation by the transferor was provided in respect of a particular period; and

(c) Option D: the "expense/time-based matching model" – recognition of income on a systematic basis over the periods which the entity recognises as expenses the related costs for which the transfers are intended to compensate and includes deferred income recognition for unenforceable conditions.[4]

Tier 3 revenue/income discussion yet to be addressed

5 Following the decisions made by the Board and stakeholder feedback, this paper addresses how to develop an approach to address stakeholder requests for a simplified approach removing the need to consider two sets of criteria currently contained in AASB 15 and AASB 1058. This development includes consideration of whether a distinction for the accounting of inflows of resources (other than volunteer services) is required, and if so, on what basis. Such an approach would cover transfers that are within the scope of AASB 15 and transfers within the scope of AASB 1058.[5]

6 The paper does not consider any transactions scoped out of AASB 1058 and AASB 15.[6] Agenda Paper 5.2.2 focuses on simplification options for interest and dividends. Other inflows of resources that may result in an income, such as rental income are not considered in this staff paper.[7]

7 Staff have further expanded the high-level scenarios presented in Agenda Paper 11.4 at the February 2022 meeting to illustrate the differences in the possible income recognition options presented in this staff paper in Agenda paper 5.1.3.

Attachment

Agenda Paper 5.1.3 Supporting document: High-level examples providing a comparison of the outcomes of the possible income recognition options and other supporting material

Structure of this agenda item

8 This paper is structured as follows:

(a) Summary of staff recommendations (paragraphs 9 – 10);

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4 As part of the further analysis, staff have modified Option B and Option C presented in February 2022 for this staff paper.

5 Agenda Paper 5.1.2 will address whether to require the assessment of 'sufficiently specific' criteria for accounting of inflows of resources with performance obligations if a distinction for the accounting for inflows of resources is required.

6 Paragraph 5 of AASB 15 scoped out transactions including lease contracts, insurance contracts and financial instruments, and paragraph 7 of AASB 1058 scoped out transactions relating to share-based payment transactions, business combinations, insurance contracts, licenses, income taxes and restructures of administrative arrangements.

7 Initial stakeholder feedback did not identify any concerns with the current accounting requirements for other transactions, nor the need for any possible Tier 3 simplifications or alternative options.

Current accounting requirements and whether there is a reason for the Board to address

(b) current requirements under Australian Accounting Standards (paragraphs 11 – 17);

(c) Australian legislative requirements (paragraph 18);

(d) summary of approaches taken by selected other jurisdictions (paragraph 19);

(e) summary of feedback from Australian stakeholders (paragraph 20);

(f) findings from academic research and other literature (paragraph 21); and

Considering options for simplifications and staff analysis and recommendations

(g) simplification of options for Tier 3 income recognition model flowchart (Figure 1 and paragraphs 22 – 24);

  (i) is a distinction required for the accounting for inflows of resources? (Table 1and paragraphs 25 – 27);

  (ii) how to require distinction for the accounting for different types of inflows of resources (Table 2and paragraphs 28 – 30); and

  (iii) options for Tier 3 reporting requirements on all inflows of resources if no distinction for the accounting for different inflows of resources is required (Table 3 and paragraphs 31 – 32).

Summary of staff recommendations in this paper

9 Staff recommend Tier 3 reporting requirements for income recognition require an entity to distinguish between inflows of resources based on whether the inflows of resources contain an explicit stipulation given by a transfer provider to use the inflows of resources in a particular way, or to act or perform in a particular way, that results in the outflows of resources that are expected to be used by the NFP entity in fulfilling its obligations. An explicit stipulation to use the inflows of resources in a particular way or to act or perform in a particular way, include:

(a) transfer of goods and/or services;

(b) perform a specified activity;

(c) incur eligible expenditure for a specified purpose that is not an identifiable specified activity covered by paragraph 9(b); and

(d) use the inflows of resources in respect of a specified time period as stipulated by the resource transferor.

Any inflows of resources received for general purposes or to fund current operations without time stipulation from transfer provider will not meet the criteria of explicit stipulation to use resources in a particular way or to act or perform in a particular way.

10 Staff further recommend that documentation between the transferor and transferee is required to consider that the stipulation is explicit.

Current requirements under Australian Accounting Standards

11 NFP private sector reporting entities are required to comply with AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities* when accounting for revenue and income (other standards provide requirements for particular types of the income, such as AASB 16 *Leases* and AASB 9 *Financial Instruments*).

12 A high-level summary of AASB 15 and AASB 1058 requirements has been provided below in paragraphs 13 – 17.

AASB 15 Revenue from Contracts with Customers – *a high-level summary*

13 AASB 15 applies to revenue arising from a contract (in writing, orally or in accordance with customary business practices) that has commercial substance, with identifiable rights for each party and payment terms for the goods or services to be transferred, and it is probable the entity will collect the consideration in exchange for the goods or services that will be transferred to the customer.

14 An entity must identify and assess the performance obligation for the goods or services promised to transfer to the customer that is either a bundle or a series with substantially the same pattern of distinct goods or services.[8]

15 An entity recognises revenue when (or as) the entity satisfies the performance obligations when the promised goods or services (i.e. an asset) is transferred, and the customer obtains control of that asset. An entity may transfer control of a good or service over time (e.g. a cleaning service) or at a point in time (e.g. sale of goods at retail). Where the performance obligation is satisfied over time, an entity is required to apply an appropriate method, using input and output methods, with consideration of the nature of the goods or service in measuring the progress towards complete satisfaction of that performance obligation.

Measurement

16 An entity is required to determine the transaction price, that is, the amount of consideration an entity expects to be entitled to in exchange for transferring the promised goods or services to a customer. Revenue is recognised based on the amount of the allocated transaction price when (or as) a performance obligation is satisfied. The transaction price is allocated to each performance obligation on a relative stand-alone selling price basis unless this is not directly observable, in which case an entity is required to estimate the stand-alone selling price using techniques such as the adjusted market assessment, expected costs plus margin or the residual approach.

AASB 1058 Income from Not-for-Profit Entities – *a high-level summary* (summarised in AP 11.4 at the February 2022 Board meeting)

17 AASB 1058 applies to transactions where the consideration to acquire an asset is significantly less than fair value, principally to enable an NFP entity to further its objects. Income other than revenue from contracts with customers and interest would be recognised immediately upon recognising an inflow of an asset (unless a related lease liability, financial instrument, provision or another related amount exists) except to the extent that the entity has an enforceable obligation to use a transferred financial asset to acquire or construct a recognisable non-financial asset to be controlled by the entity.

Australian legislative requirements

18 As presented in Agenda 11.4 presented at the February 2022 AASB Board meeting, the staff's review of the Australian legislation governing NFP entities noted that changes to revenue and other income accounting may have an impact on the determination of the size thresholds for financial reporting requirements, and may have an impact on whether an entity qualifies for a particular financial reporting tier.

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8 A transfer of goods or services is distinct if the customer can benefit from the goods or services either on their own or together with other resources readily available to the customer, and the entity's promise to transfer the goods or services to the customer is separately identifiable from other promises in the contract.

Summary of approaches taken by selected other jurisdictions

19 When considering this topic, staff had regard to the requirements that apply to smaller NFP entities of other jurisdictions.[9] The summary from our review is as follows:

Income type/Jurisdiction	Revenue from sales of goods/services	Revenue/Income with conditions	Revenue/Income without conditions
IFRS for SME / UK FRS 102 and UK Charities SORP	Revenue from sales when an entity transfers significant risk and rewards of ownership and when services are provided (stage of completion method).[10]	Grants/donations recognised as conditions are met.	Grants/donations recognised when entitled to the resource.
NZ Tier 3	Revenue from sales of goods recognised when sale occurs (usually when goods are received by the purchaser) or when services are provided (stage of completion method).	Grants/donations with 'use or return' conditions – income recognised when conditions are met.[11]	Grants/donations recognised when cash received.
Singapore CAS	Income from providing goods or services is earned to the extent the goods and/or service provided.	Grants/donations recognised as conditions are met.	Grants/donations recognised when entitled to the resource.
HK SME FRF and SME-FRS	Same as IFRS for SMEs/FRS 102.	Grants recognised over period necessary to match them with related costs they are intended to compensate on a systematic basis.	Grants as received if purpose is to compensate for expenses incurred or for giving immediate financial support.
Canada ASNFPO	Same as IFRS for SMEs/FRS 102.	Grants/donations recognised either in the same period as expenses	Grants/donations recognised when cash received.

9 Staff considered the components of financial statements from the following selected jurisdictions: International United Kingdom – IFRS for SMEs, United Kingdom – FRS 102 *The Financial Reporting Standards applicable in the UK and Republic of Ireland* (FRS 102) – Section 1A small entities regime and Charities SORP (102) *Accounting and Reporting by Charities: Statement of Recommended Practice* (Charities SORP), New Zealand – *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)* (NZ Tier 3 Standard), Canada – Part III of the Handbook Accounting Standards for Not-for-profit Organisations (Canada ASNFPO), Singapore – *Charities Accounting Standard, Hong Kong – Small and Medium-sized Entity Financial Reporting Standard* (HK SMEFRF & SME-FRS), and United States of America – Not-for-profit Entities (Topic 958) (US ASC NFP 958).

10 As part of the IASB's second comprehensive review of the *IFRS for SMEs* Standard, the IASB had tentatively decided at its February 2022 meeting proposing amendments to align the *IFRS for SMEs* Standard with IFRS 15 *Revenue from Contracts with Customers* with some simplifications as noted in Agenda Paper 4.1 presented at the February 2022 AASB Board meeting.

11 As part of the NZASB PIR of its Tier 3 and 4 PBE Standards, the NZASB has decided at its March 2022 meeting to propose amending its revenue recognition model to recognise significant grants/donations as or when expectations over use are satisfied (either over time, or at a point in time) with appropriate guidance to be developed, and to clarify that expectations are documented when agreed in writing (or there is some other form of evidence to demonstrate this agreement) and that the expectation (as documented) is specific enough to allow the reporting entity to reliably demonstrate to the resource provider when the expectation has been satisfied (regardless whether the resource provider monitors the use of the funding provided or not).

Income type/Jurisdiction	Revenue from sales of goods/services	Revenue/Income with conditions	Revenue/Income without conditions
		incurred or using fund accounting.	
US ASC NFP 958	Revenue from sales of goods or services recognised similarly as AASB 15.	Grants/donations – If the agreement includes donor-imposed conditions, then income recognised as conditions are met.	Grants/donations recognised when cash received.
IPSASB **ED 70** **ED 71**	Revenue from sales of goods or services recognised similarly as AASB 15 but customers can be beneficiary as a third party.	Grants/donations recognised as present obligations are met	Revenue/grants/donations recognised when recipient has control of the resources.
IFRS4NPO (consultation paper)	No sector-specific issues regarding exchange revenue were identified hence consultation paper does not cover these types of transactions.	Four alternatives provided for comment for non-exchange transactions: i. Use IFRS for SME concepts and principles ii. Use IAS 20 iii. Use IPSASB 23 iv. Use IPSASB 23 with exceptions.[12]	

Summary of feedback from Australian stakeholders

20 The following summarises feedback relevant to the topics covered in this staff paper, including from the AASB NFP Project Advisory Panel (NFP PAP) meetings held on 18 May 2021[13] and 8 March 2022:[14]

(a) Several NFP PAP members noted that NFP entities encounter difficulties identifying the distinction between recognition of revenue under AASB 15 and recognition of income under AASB 1058, and suggested Tier 3 recognition of revenue and other income should be developed as a single integrated section of the Tier 3 Standard.

(b) There was little support to revert to the 'significant risk and rewards of ownership' model in the superseded AASB 118 *Revenue*. A few members supported the straightforward approach adopted by the NZ Tier 3 Standard, while one member considered simplifying the recognition principles in AASB 15 instead.

(c) Most NFP PAP members expressed concern that many transferred assets under AASB 1058 resulted in immediate income recognition where there may be conditions to apply the transferred assets in future periods or raised for specific purposes. The concerns included:

(i) the inability to defer income can impact an NFP entity's ability to generate income from other sources due to the entity showing a 'healthy' surplus;

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12 Consultation feedback indicated stakeholders' preference to recognise non-exchange revenue using the principles in IPSAS 23 and introduce exceptions to the requirements for gifts in-kind based on some national standards and to provide NPO-specific guidance.

13 Refer Agenda Paper 3.4 *Not-for-Profit Project Advisory Panel minutes from 18 May 2021 meeting* from the 20-21 June 2021 AASB meeting.

14 Refer Agenda Paper 4.4 Draft *Not-for-Profit Project Advisory Panel minutes from 8 March 2022 meeting* from the 9 April 2022 AASB meeting.

(ii) funding/oversight bodies (users) whose expectations of the underlying basis of income recognition often differ from the basis applied; and

(iii) differences between statutory and management reporting resulting in duplication of reporting.

(d) There were mixed views on how to simplify income recognition of grants, donation and bequests, with some members supporting the matching principle as it aligns with users' expectations of the transferred resources. However, one member noted that this may result in a 'free for all' deferral approach without regard to enforceability attached to transferred resources. A few members suggested to include a simpler test of 'use or return' condition accompanying the transferred resources in place of the residual approach of applying AASB 15 first. This is similar to the existing criterion specified in NZ Tier 3 Standard as well as the 'enforceable conditions model' as referenced in paragraph 4(a) which would result in grants or donations being reasonably deferred except for when they are received for general purposes.

(e) PAP members noted other matters, including consideration of donations received for tax-deductibility purposes must not have any conditions attached to specific performance obligations. Tier 3 requirements should not require smaller NFP entities to assess each agreement to consider enforceability or deferral of income for all scenarios (e.g. non-refundable school fees).

Findings from academic research and other literature

21 As noted in AP 11.4 at the February 2022 and AP 4.1 at the April 2022 Board meeting, academic research indicated that accrual accounting provides useful information to encourage donors and assure or support regulators. Some specific issues identified facing NFP entities from various research papers include:

(a) non-reciprocal or non-exchange transfers from donors that have conditions or restrictions attached and valuing the contributions of volunteers (albeit in the context of the appropriateness of the conceptual framework);[15]

(b) AASB 15 and AASB 1058 were identified as adding complexity and possibly reducing understanding of users as the recognition of income from grants, capital funds or procurement processes where the outcome related to the purpose of the funding was not sufficiently clear to allow the staged recognition as the expenses were incurred resulting in profitable performance, threatening potential resourcing opportunities. As such, there is support amongst users, preparers and auditors for a simpler income recognition approach such as the matching principle which could help users better understand the accounting for an entity's revenue and income;[16] and

(c) NFP entities do not have the necessary knowledge to prepare financial statements compliant with the Australian Accounting Standards, with AASB 15 and AASB 1058 identified as accounting standards being problematic for some charities and not aligned with user expectations within the sector.[17]

15 *The non-profit accounting mess* (Anthony, R. N., 1995)

16 *Decision Usefulness: A re-examination of the information needs of non-profit GPFR users* (Gilchrist, D., Furneaux, C., West, A. and Zhang, Y., 2021)

17 *Annual Reports of Australian Not-for-Profit Organisations: Insights from internal and external stakeholders* (Judd, C., Muir, J., Pathirange, N. & Shying, M., February 2022)

Options for simplification

22 With reference to the 'Approach to simplification' flowchart in Appendix A of Agenda Paper 5.1.3, the staff analysis considers current practice in Australia and international jurisdictions, feedback received from stakeholders, and the findings summarised in paragraphs 11 to 21 above. Staff have presented the options for simplification in Figure 1 'Simplification options for Tier 3 income recognition model' flowchart presented on the following page regarding:

(a) whether, and how, an integrated approach can be developed, including whether a distinction for the accounting for inflows of resources is required by Tier 3 entities – considered in this staff paper. This information is represented by the **red box** in the flowchart. Staff recommendations are shaded in **yellow**; and

(b) whether to require the assessment of 'sufficiently specific' criteria for the accounting of inflows of resources with obligations (such as explicit stipulation or reciprocal transactions) – considered in Agenda Paper 5.1.2.

Staff also acknowledge that there may be other possible combinations of options (e.g. Options 4A and 4B can apply to the consideration for Option 1A below) that the Board may decide to be an appropriate option for consideration. As such, Option 1A may also be relevant when determining whether to require 'sufficiently specific' criteria in Agenda Paper 5.1.2 (as presented with a dotted line to A.P. 5.1.2 Q1).

23 Agenda Paper 5.1.3 presents six high-level scenarios to illustrate the differences in the outcomes of the identified income recognition options.[18] The scenarios cover inflows of resources an entity receives for:

(a) sales of goods and/or services;

(b) operational funding in current year to be spent in the following financial year;

(c) funds to employ staff and fund their salaries;

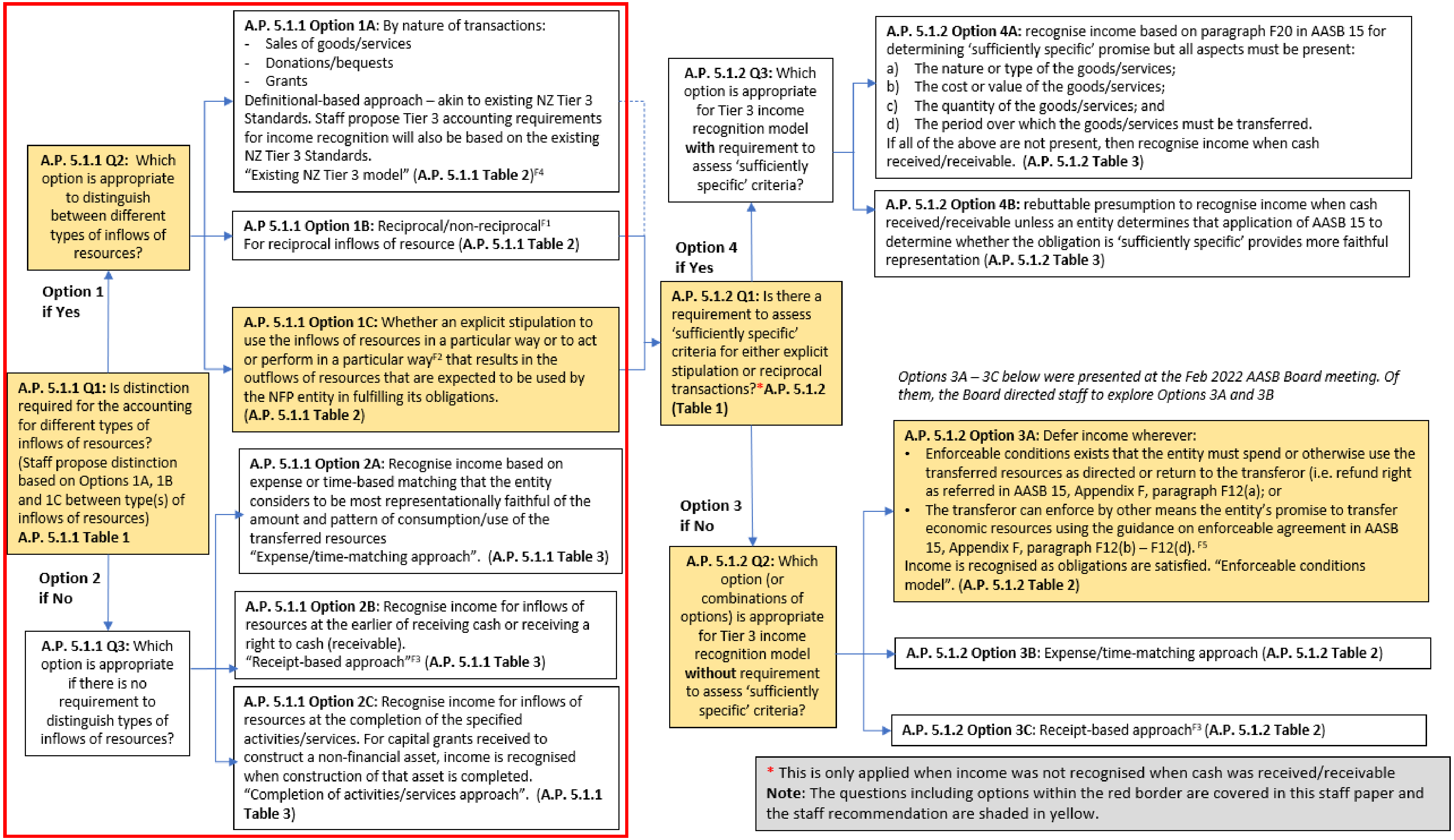
(d) operational funding to further entity's objectives;

(e) funds to construct a non-financial asset; and

(f) performing a research activity.

18 The scenarios apply to consideration of Options 1A, 2A, 2B and 2C in this staff paper.

Figure 1: Simplification options for Tier 3 income recognition model



Footnotes to flowchart:

F1 AASB 1004 defines ‘non-reciprocal transfer’ as a transfer in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer.

F2 An explicit stipulation to use the transferred resources in a particular way or to act or perform in a particular way, including to:

a) transfer goods and/or services (i.e. akin to performance obligation recognised under AASB 15)

b) perform a specified activity (e.g. akin to construct a non-financial asset under AASB 1058 or conduct a form of research for the entity’s benefit);

c) incur eligible expenditure (i.e. incur expenditure for a specified purpose that is not an identifiable specified activity covered by (b)), e.g. funding is provided to a university to employ a marketing manager to promote the university’s courses to overseas students; or

d) use the transferred resources in respect of a specified time period as stipulated by the resource transferor.

Any use of transferred resources for general purposes or to fund current operations without a time stipulation from transfer provider will not meet the definition of using resources in a particular way or to act or perform in a particular way.

F3 Whilst the Board indicated in its February 2022 meeting for staff not to pursue this option for the recognition of grants, donations or bequest as income, staff consider it may be an option for recognition of *ad hoc* sales of goods/services as income and for completeness of documenting the options considered.

F4 If the Board prefers Option 1A (i.e. distinction based on nature of transactions), then determining whether to require assessment of ‘sufficiently specific’ criteria may also be a relevant consideration in Question 1 of this staff paper.

F5 AASB 15, Appendix F, paragraph F12(a) – (d) lists the following examples of terms that result in enforceable agreements:

a) a refund in cash or kind is required when the agreed specific performance has not occurred;

b) the customer, or another party acting on its behalf, has a right to enforce specific performance or claim damages;

c) the customer has the right to take a financial interest in assets purchases or constructed by the entity with resources provided under the agreement; and

d) the parties to the agreement are required to agree on alternative uses of the resources provided under the agreement.

24 Staff have identified the following options, including staff analysis and recommendations for Tier 3 reporting requirements regarding:

(a) whether a distinction is required for the accounting for inflows of resources (Table 1);

(i) if a distinction is required – options on how to distinguish between different types of inflows of resources (Table 2); and

(ii) if a distinction is not required – options on accounting requirements for income recognition <u>without</u> requiring the distinction for the accounting for inflows of resources (Table 3).

Table 1: *Is a distinction required for the accounting for different types of inflows of resources?*

Possible options for Tier 3 – requirement for a distinction for the accounting for different inflows of resources	**Option 1: To require distinction for the accounting for inflows of resources**	**Option 2: Not require distinction for the accounting of inflows of resources**
	Should the Board decide that a distinction is required for accounting for inflows of resources, staff are proposing that the distinction may be based on: Option 1A) the nature of the transaction, Option 1B) reciprocal or non-reciprocal determination, or Option 1C) whether explicit stipulation is given by a transfer provider attached to the inflow of resources, as discussed in Table 2.	This option applies the same accounting requirements to all inflows of resources regardless of type of the transaction, whether distinguished by its nature or whether there are any explicit obligations from the transfer provider or enforceability attached to the inflows of resources. As such, this option would give rise to the same outcome/treatment of all inflows of resources
Jurisdiction adopting similar approaches (and pronouncement)	• AABS 15 and AASB 1058 • IFRS for SMEs/UK FRS 102/UK Charities SORP • Singapore CAS • US ASC NFP 958 • Canada ASNFPO • NZ Tier 3 Standard • HK SME-FRF and SME-FRS • IPSASB	• No jurisdiction identified
Support for this approach	• To require distinction for accounting for inflows of resources recognises that different recognition requirements may be warranted depending on the type of transaction which may be based on, for example, the nature of the transaction or whether there are stipulations which may specify to perform activities or incurring expenditure attached to the resource from the transfer provider, rather than treating all inflows of resources in the same manner. • Aligns with user understanding of the financial statements for inflows of resources with stipulation by funding/oversight bodies (users) that the NFP entity is required to use the transferred resources as specified by the transfer provider. • Consistent with other selected jurisdictions reviewed of the accounting requirements for smaller entities that have different accounting requirements for different types of inflows of resources. • Consistent with the principles of the Conceptual Framework where inflows of resources subject to conditions/obligation give rise to assets/liabilities as defined in the Conceptual Framework. • Leverages management's information used in decision making that an entity is required to separately account for grant acquittal purposes versus provision of goods and services.	• Provides simplification by removing judgement and requires less interpretation by not requiring distinction for the accounting of inflows of resources and applying the same recognition accounting requirement regardless the nature of the transaction, or whether there are conditions or stipulation to perform activities/incur expenditure attached to the use of the resource. • It is a proportionate response for a lower-level differential reporting tier as it recognises the initial feedback from stakeholders that smaller NFP entities are less well-resourced to distinguish between and apply different accounting requirements to different types of inflows of resources. • Even though management may be required to acquit grants, distinguishing between whether grants contain conditions versus provision of goods or services is not always clear cut.

Possible options for Tier 3 – requirement for a distinction for the accounting for different inflows of resources	Option 1: To require distinction for the accounting for inflows of resources	Option 2: Not require distinction for the accounting of inflows of resources
	• It may help with presentation requirements in the primary financial statements if distinction for the accounting for inflows of resources is required.[19] • Maintains consistency with the requirements applying to other NFP entities which do not apply the same accounting treatment for all inflows of resources.	

19 The Board decided at its November 2021 Board meeting to propose in the DP to replicate the Tier 2 requirements for the information presented on the face of the primary financial statements supplemented by guidance or education material (refer to minutes of the 184th meeting of the AASB).

Staff recommendation

25 Staff recommend Option 1, that the proposed Tier 3 reporting requirements should require distinction for inflows of resources for the following reasons:

(a) Inflows of resources may have stipulations attached to perform a specified activity or incur expenditure given by the transfer provider, or the resources may be derived from different sources (e.g. revenue from sales of goods or services or grants or donations). As such, different accounting requirements may be warranted between the different types of inflows of resources reflected in the options in Table 2 below. Requiring distinction for inflows of resources also ensures that funding or oversight bodies (users) are provided with relevant information relating to inflows of resources with stipulations, and the NFP entity is expected to meet those stipulations.

(b) Staff note that developing a simplified integrated approach does not necessarily mean applying the same recognition requirements for all inflows of resources and resulting in the same accounting outcome. Feedback from stakeholders consider that inflows of resources given for a specific purpose with enforceability from a donor or grantor should be accounted for differently (e.g. deferred income recognition) from general purpose grants or donations (e.g. income recognised when grants/donations received). Staff think that a Tier 3 income recognition model that applies a single recognition requirement to all inflows of resources would not sufficiently distinguish the different nature and conditions attached to NFP income transactions. Staff consider that requiring the distinction for the accounting for different inflows of resources would still address stakeholders' concerns to allow an integrated income recognition model to apply to different types of inflows of resources.

Question to Board members

Q1 Do Board members agree, for the purpose of the DP, with the staff recommendation that Tier 3 reporting requirements should require distinction for the accounting for inflows of resources (Option 1)?

If the Board members disagree, what approach do Board members support?

26 If Board members **agree** with the staff recommendation in Question 1 that Tier 3 reporting requirements should continue to require distinction for the accounting for inflows of resources, the simplification options on how to require a distinction between different inflows of resources are presented and analysed in **Table 2 and paragraphs 28 – 29** below.

27 If Board members **do not agree** with the staff recommendation in Question 1 and that Tier 3 reporting requirements should not require distinction for the accounting for inflows of resources, the simplification options for the accounting requirements for income recognition for all inflows of resources are analysed in **Table 3 and paragraphs 31 – 32** below.

Note this section is relevant only if the Board agrees with the staff recommendation in Question 1

Table 2: *Summary of possible options and analysis for Tier 3 – how to require a distinction for the accounting for different types of inflows of resources*

Possible options for Tier 3 – how to require a distinction between different types of inflows of resources	Support for the approach	Arguments against the approach
Option 1A: distinction based on the **nature of the transaction** a definitional-based approach to income recognition of each type of transaction. This approach is akin to the NZ Tier 3 Standard, which specifies the reporting requirements for different types of inflows of resources. Staff have considered that, for this option, **income recognition requirements** would also be **based on the existing NZ Tier 3 Standard**[20] to differentiate this option from Option 1C. Option 1A is referred to as the "Existing NZ model".	• NFP entities may already be distinguishing the different types of inflows of resources based on their nature when preparing their financial statements, as such this approach should not impose any additional cost and leverages information currently used by management. • Smaller entities with fewer resources may prefer a definitional-based approach to the accounting requirements for different inflows of resources and arguably reduce judgement and interpretation needed to determine the appropriate accounting requirements. • Improves consistency between Tier 3-sized entities as a more rules-based approach to accounting requirements.	• This is the current approach where the accounting requirements are based on the nature of the inflows of resources in first instance, that is a distinction between transactions with customers and transactions where an asset was acquired for significantly lower than its fair value. However, stakeholder feedback expressed concern that there can be ambiguity when determining the accounting requirements for grants/donations that have performance obligations which warrants a different accounting requirement to those grants/donations without performance obligations, even though the nature of the transaction is the same. As such, this appears to be a two-step process rather than a single integrated approach. • NFP entities operate in a diverse environment, as such a definitional-based approach may not be sufficient to address the broad arrangements entered into by Tier 3 entities. • NZ Tier 3 Standard requires classification of revenue categories to be presented on the face of the financial statements (e.g. revenue from commercial activities, funding from services delivery from government and non-government), warranting an income recognition approach based on the nature of the transaction. In contrast, the Board has decided that the presentation of financial statements for Tier 3 should be based on Tier 2 reporting requirements to allow more flexibility in the presentation requirements. Creating a definitional-based approach to account for different types of inflows of resources based on nature may not be suitable. • Feedback from NZASB's PIR indicated that the deferral of income recognition for grants, donations or bequests based on a 'use or return' condition may be too restrictive.

20 The existing NZ Tier 3 income recognition for grants, donations and bequests is to defer income if a 'use or return' condition is attached. Income is recognised for sales of goods when goods are sold and for provision of services by reference to the stage of completion of services at balance date, based on the actual service provided as a percentage of the total service to be provided.

Possible options for Tier 3 – how to require a distinction between different types of inflows of resources	Support for the approach	Arguments against the approach
Option 1B: distinction based on whether the **reciprocal or non-reciprocal determination** attached to the inflows of resources, that is a similar approach to that applied in the superseded AASB 1004 *Contributions.*[21]	• Developing an integrated approach based on whether inflow of resources is reciprocal or non-reciprocal would be more principle-based approach than Option 1A.	• Identifying whether a transaction was reciprocal or non-reciprocal in practice was not always straightforward which led to divergence of interpretations and inconsistencies, as noted in the basis for conclusions of AASB 1058.[22] • Many transfers of inflows of resources given to an NFP entity may fall outside the definition of a reciprocal transfer.
Option 1C: distinction based on whether the inflows of resources contain **explicit stipulation**[23] given by a transfer provider (which can include grantors, donors or customers) to use the inflow of resources in a particular way or to act or perform in a particular way[24] that results in the outflow of resources that are expected to be used by the NFP entity in fulfilling the stipulations.[25] This approach is similar to the NZ Tier 3 approach proposed in the upcoming ED in determining whether an expectation over how the funds will be used, as communicated by the transfer provider, for revenue	• Recognises stakeholder feedback that income recognition should allow deferral where there is a specific stipulation that an NFP entity needs to fulfil regardless of whether it is with customers. • Similar to Option 1B, developing an integrated approach based on whether there are explicit stipulations would be more principle-based approach than Option 1A. • Simplifies the distinction process to only require an entity to determine whether there are explicit stipulations with documentation to support the assessment allows NFP entities to utilise fewer resources in identifying stipulations from those that are implicit, and stakeholder feedback indicated that assessing whether stipulation is attached is not onerous. Requiring documentation in considering whether stipulation is explicit helps auditors to provide assurance on the assessment. Further, NFP PAP members considered that Tier 3 entities should not be required to assess each agreement based on cost versus benefit considerations. • Leverages information used by management in decision making as it is expected that management would already be required to determine if	• May still require judgement for entities to identify whether a stipulation to use the inflows of resources is given by a transfer provider to use the resources in a particular way meets the criteria in footnote F2 of Figure 1 • Departure from Tier 1 or Tier 2 requirements, although certain areas overlap (e.g. identifying if stipulation is akin to performance obligations however without 'sufficiently specific' criteria). • There may be more time and cost to ensure documentation is provided between grantors/donors/customers and the NFP entity to prove that the stipulation attached to the inflows of resources is explicit (however, this is likely already available for grant acquittal purposes). • Time and cost required for entities to understand and apply the new requirements, including the application of terms 'explicit'.

21 Prior to the introduction of AASB 1058, NFP entities were required to comply with AASB 1004 for the accounting requirements of income arising from contribution of assets. Refer to Appendix B in Agenda Paper 5.1.3 for an excerpt from the superseded AASB 1004.

22 The Basis for conclusions in AASB 1058 identified the need for change to address issues with identifying whether a transaction was reciprocal or non-reciprocal under superseded AASB 1004. Refer to Appendix C in Agenda Paper 5.1.3 for an excerpt of paragraphs BC2 – BC7 from AASB 1058.

23 Staff have used the term 'stipulation' rather than 'obligation' as 'obligation' is generally referred to synonymously with liabilities and Option 1C makes clear that only some obligations would qualify as liabilities.

24 Refer to footnote F2 of Figure 1 for the list of explicit stipulations to use the inflows of resources in a particular way or to act or perform in a particular way.

25 This option is a combination of the IPSASB ED 71 which requires an outflow of resources that are expected to be used by the NFP entity, and the NZ Tier 3 approach to be proposed in their upcoming ED in determining whether an expectation over how the funds will be used, as communicated by the transfer provider, for revenue recognition of grants, donations, bequests and pledges. This option may be narrower than the notion of expectations and will apply to all transfers of resources

Possible options for Tier 3 – how to require a distinction between different types of inflows of resources	Support for the approach	Arguments against the approach
recognition of grants, donations, and bequests pledges. This option may be narrower than the notion of expectations and will apply to all transfers of resources. Documentation in writing between the transferor and transferee is required to assess if the stipulation is explicit.	the inflows of resources contain stipulations from the transfer provider that resources should be used in a particular way (e.g. grant acquittal purposes). • Simplifies the current approach to determining whether a transaction should be recognised under AASB 15 or AASB 1058. It does not require identification of whether a promise to transfer goods/services is distinct or not.	

Evaluation of options against the Tier 3 development principles

28 With reference to the 'Approach to simplification' flowchart in Appendix A of Agenda Paper 5.1.3, in addition the analysis in Table 2 above, staff also analysed each of the proposed options against the tentative Tier 3 principles previously agreed to by the Board members. Staff consider that the Options 1A and 1C do broadly align with the Tier 3 principles but Option 1B does not, as listed below:

Principles	Staff assessment
Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful information to users of financial statements	Option 1B may not provide useful information to users as there may be transfers of inflows with conditions or specified activities attached that could be categorised as non-reciprocal transfers. As such, this approach may not align with the user expectations of how these inflows should be recognised.
Consistency with the accounting principles specified in Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable but might not always be warranted since Tier 3 requirements are being developed as a proportionate response Accounting requirements do not impose disproportionate costs to preparers compared to the benefits of the information	Option 1B does not align with Tier 2 accounting principles and may not be desirable given the judgement and difficulties when determining when a transaction is categorised as reciprocal and non-reciprocal, and may impose more cost to preparers. Option 1C may still require judgement to identify whether stipulation to use the inflows of resources is present (i.e. whether stipulation satisfies the description in footnote F2 of Figure 1), which may impose some cost to preparers. However, stakeholder feedback has indicated that assessing if the stipulation is attached to inflows of resources should not be onerous and aligns with users' understanding of the liability attached to the inflows of resources.
Where possible, leverage the information management uses to make decisions about the entity's operations. The ability to leverage the information management uses is made within the context of the NFP conceptual framework, user needs and cost/benefit considerations, and aim for comparability within Tier 3 reporting requirements.	Option 1B does not leverage information management uses where there may be inflows of resources categorised as non-reciprocal, even though there may be conditions or specified activities attached to those transactions which the entity is expected to perform/deliver. Option 1A may not leverage the information management uses as indicated by NZASB feedback from its PIR that the 'use or return' criteria may be too narrow.

Staff recommendation

29 Staff recommend requiring a distinction for the accounting for different types of inflows of resources based on Option 1C. That is, the proposed Tier 3 reporting requirements should require distinction based on whether the inflows of resources contain explicit stipulation given by the transfer provider to use the inflow of resources in a particular way or to act or perform in a particular way that results in the outflow of resources that are expected to be used by the NFP entity in fulfilling its obligations. Documentation between the transferor and transferee is required to support assessing if the stipulation is explicit. Staff think that this is an appropriate and proportionate response in recognition of the size of Tier 3 entities and were persuaded to their view by the following considerations:

(a) Feedback from initial staff outreach and members of the NFP PAP indicated the difficulties NFP entities have in determining whether a transaction falls within AASB 15 or AASB 1058, and that Tier 3 should be developed using an integrated approach for income/revenue recognition. As such, requiring distinction for the accounting for different inflows of resources based on whether there are explicit stipulations from the transfer provider (i.e. either from a customer or a grantor/funder) to use the inflows of resources in a particular way or to act or perform in a particular way enables an integrated approach to be applied.

(b) Requiring the distinction for the accounting for inflows of resources allows different accounting requirements to be developed for inflows of resources with explicit stipulations attached (i.e. deferral of income recognition) to those inflows of resources without explicit stipulations (i.e. immediate income recognition), which may enable more relevant information to be provided to meet a transfer provider's expectations of the entity's use of the inflows of resources.

(c) Staff recognise that donations may contain implicit intentions from donors/grantors how the inflow of resources should be used by the NFP entity (e.g. a NFP entity receiving an annual grant each year without time stipulation where the donor may have an implicit intention that the grant should be spent within one financial year). However, implicit intentions may be subjective and may lead to increased judgement when assessing whether there are attached stipulations. There may also be difficulties providing assurance on implicit intentions. To simplify the distinction process, Option 1C requires distinction for the accounting for different inflows of resources only based on explicit stipulations.

Question to Board members

Q2 Do Board members agree, for the purpose of the DP, with the staff recommendation that Tier 3 reporting requirements should require distinction for the accounting for different inflow of resources based on **Option 1C.**

Note, if the Board agrees with the staff recommendation, Agenda Paper 5.1.2 will consider whether to require the assessment of 'sufficiently specific' criteria for accounting of inflows of resources with explicit stipulation (or reciprocal transactions).

If the Board disagree with the staff recommendation, which approach do Board members support?

30 If the Board:

(a) Agrees with the staff recommendation of Option 1C in Question 2 above, that the distinction should be based on whether the inflows of resources contain explicit stipulation given by the transfer provider to use the inflow of resources in a particular way or to act or perform in a particular way that results in the outflow of resources that are expected to be used by the NFP entity in fulfilling its obligations; or

(b) prefers Option 1A or Option 1B in Question 2. That is, the distinction should be based on whether the inflows of resources are categorised based on the nature of the transaction or a reciprocal or non-reciprocal determination;

then staff have identified simplification options for Tier 3 reporting requirements on whether an entity is required to assess 'sufficiently specific' criteria and options for simplification of Tier 3 income recognition model in Agenda Paper 5.1.2.

Note: This section is relevant only if the Board does not agree with the staff recommendation in Question 1

Table 3 *Summary of possible options and analysis for Tier 3* – accounting requirements for income recognition <u>without</u> requiring the distinction for the accounting for different inflows of resources

Possible options for Tier 3 – accounting requirements for income recognition without requiring the distinction for the accounting for different inflows of resources	Support for the approach	Arguments against the approach
Option 2A: Simplify the income recognition requirements to allow either **expenses or time-based matching for all transferred resources.** This approach was presented at the February 2022 AASB Board meeting and is similar to the approach applied in AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* (but extends to all inflows of resources regardless if there are conditions/obligations over the transferred assets and whether they are enforceable). This option proposes that income be recognised based on either expenses or time-based matching <u>that the entity considers to be most representationally faithful</u> to the amount and pattern of consumption/used of transferred resources received. Inflows of resources related to assets, including non-monetary assets recognised at fair value may, as a presentation alternative to recognising 'deferred income' liability, deduct the amount of the grant in arriving at the carrying amount of the asset. This means recognising the inflows of resources in profit or loss as a reduced depreciation expense. As such, where the inflows of resources are received for the entire value of the asset, the effect would result in non-recognition of the asset. In this	• Consistent with AASB 120. • Expected to be less costly to apply than the existing AASB 1058 model for Tier 3 entities, removing the need to assess enforceability and specificity of conditions. • May increase the understandability of financial statements as the liability more closely aligns with the stakeholder view of a liability. • Leverages management information used in decision making due to the use of matching. • Proportionate response to issues raised by stakeholders.	• Reduces comparability between other tiers of NFP entities.[26] • A liability arising from unenforceable obligations may result in a departure from the Conceptual Framework.[27] • Enforceability is a key characteristic of a liability, and this has been removed in this option which may result in difficulty for users to identify a liability from a general obligation. • Allows the entity an option to offset funding received against a related asset purchased or constructed, which may result in non-recognition of assets and reduced information for users. • Requires entities to keep records of all expenses to enable matching of inflows of resources to related expenditure, which may increase cost and may not appear to simplify in all cases. • Entities can choose how income is deferred based on either matching expenditure or systemic allocation of

26 Paragraphs BC15 – BC17 of AASB 1058 outlined the Board's rationale to not extend the scope of AASB 120 to NFP entities including:
a) limited scope of transfers addressed by AASB 120 compared to varied transfers received by a NFP entity; and
b) application of recognition and presentation requirements in AASB 120 could result in an entity's assets being materially understated.
The Board observed that the application of requirements in AASB 120 to all transfers would require an NFP entity to defer income recognition for every form of transfers until there is reasonable assurance that the entity will comply with any conditions attached to the transfer, and AASB 120 does not define 'conditions', which may lead to inconsistency in application. The Board also noted the inconsistency of the nature of obligation giving rise to a liability rather than income with the principles of the Conceptual Framework.

27 The IASB in its Third Agenda Consultation issued in March 2021 noted the stakeholder feedback on IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* related to the timing of income which is based on reasonable assurance and matching of costs with income rather than satisfaction of performance obligations identified in a grant, with matching of costs with income not being an objective of the Conceptual Framework.

Possible options for Tier 3 – accounting requirements for income recognition without requiring the distinction for the accounting for different inflows of resources	Support for the approach	Arguments against the approach
paper, this model referred to as the "expense/time-based matching model".		expenditure, reducing consistency amongst Tier 3 entities. For funding provided for a general purpose, an entity can indefinitely defer income (in extreme cases).
Option 2B: simplify the income recognition requirements to recognise income at the earlier of receiving cash or receiving a right to cash (receivable). In this paper, this is referred to as the "Receipt-based model".	• Least costly model since an entity is not required to consider any terms and conditions within the agreement to determine accounting treatment. • Simplifies judgement and interpretation of accounting requirements.	• Does not reflect the pattern of transfer of specific goods/services with the contract/document/explicit direction of donor/funder • Causes mismatch between receipt of funds and corresponding expenditure for all contracts which overlap a financial period. • Conflicts with stakeholder feedback in respect of user needs. • Would likely increase volatility of results as income and expense are more likely recognised in different periods compared to current requirements of AASB 15 and AASB 1058. • Results in more recognition of income on receipt of cash/cash receivable.
Option 2C: simplify the income recognition requirements to recognise income **at the completion of the specified activities/services**. For capital grants received to construct a non-financial asset, income is recognised when construction of that asset is completed. In this paper, this is referred to as the "completion of activities/services model".	• Similar to Option 2B, least costly model since an entity is not required to consider any terms and conditions within the agreement to determine accounting treatment, and simplifies judgement and interpretation of accounting requirements.	• Similar to Option 2B above except that income will only be recognised when goods are delivered, after the provision of services or the construction of the non-financial asset has been completed. Therefore delaying the income recognition until the point of completion of underlying activities/services.

Evaluation of options against the Tier 3 development principles

31 With reference to the 'Approach to simplification' flowchart in Appendix A of Agenda Paper 5.1.3, in addition the analysis in Table 3 above, staff also analysed each of the proposed options against the tentative Tier 3 principles previously agreed to by the Board members. Staff consider that the proposed options may not align with the Tier 3 principles as listed below:

Principles	Staff assessment
Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful information to users of financial statements	Options 2B and 2C may not provide useful information to users because Option 2B requires income to be recognised when cash received/receivable even if there were obligations attached and Option 2C recognises income at the completion of the obligation even if the entity may have partially satisfied the obligation. Both these options would not align with the user expectations and conflict with stakeholder feedback in respect of user needs. Option 2A allows an entity to recognise income matched with relevant expenses whenever the entity considers appropriate, even where there may not be obligations specified which may not meet the definition of a liability in the Conceptual Framework. However, it may increase the understandability of financial statements as the liability more closely aligns with the stakeholder view of a liability compared to Options 2B and 2C.
Consistency with the accounting principles specified in Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable but might not always be warranted since Tier 3 requirements are being developed as a proportionate response Accounting requirements do not impose disproportionate costs to preparers compared to benefits of the information	Options 2B and 2C are not consistent with Tier 2 accounting principles as Option 2B requires all income to be recognised up front and Option 2C requires deferral of income in all cases. Option 2A may not align with Tier 2 accounting principles (even though in some scenarios it may) and it may impose more cost on preparers as it requires meticulous record keeping in order to apply the matching of income with related expenditure.
Where possible, leverage the information management uses to make decision about the entity's operations. The ability to leverage the information management uses is made within the context of the NFP conceptual framework, user needs and cost/benefit considerations, and the aim for comparability within Tier 3 reporting requirements.	Whilst both Options 2B and 2C are the least costly approaches to income recognition, however they may not always leverage information management uses as some information required is not ordinarily prepared by management and may be inconsistent with information recorded in grant acquittals. Option 2A most strongly leverages the information management uses to reflect the reporting to funding providers for grant acquittal purposes (however, this would not be applicable for all transactions).

Staff recommendation

32 If the Board decides that no distinction for the accounting for different inflows of resources is required in Question 1 above, then on balance, staff recommend Option 2A, that the proposed Tier 3 reporting requirements should allow either expenses or time-based matching that the entity considers most representationally faithful to the amount and pattern of the inflows of resources. Staff were persuaded to their view by the following considerations:

(a) this option addresses stakeholder concern for the inability of many transfers to be deferred where there is an obligation to apply the transferred asset in future periods or given or raised for specific purpose. This approach will also improve user understandability of financial statements for receipt of funds to be matched with the corresponding expenditure for all transfers which overlap a financial period, and allows the deferred income liability more closely align with many stakeholders' view of a liability;

(b) this option recognises that management may already be expected to apply the matching model to account for transfers for grant acquittal purpose; and

(c) this option simplifies the current accounting requirements by removing the need for Tier 3 entities to assess enforceability and specificity of conditions.

Question to Board members

Q3 If the Board decided not to require the distinction for accounting for different inflows of resources, do Board members agree, for the purpose of the DP, with the staff recommendation that Tier 3 reporting requirements should allow either expenses or time-based matching that the entity considers most representationally faithful to the amount and pattern of the inflows of resources (Option 2A)?

If the Board disagrees with the staff recommendation, what approach do Board members support?