Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Income of Not-for-Profit Entities**	**Meeting**	AASB June 2016 (M152)
Topic:	**Accounting for perpetual endowments**	**Agenda Item:**	3.2
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Introduction and objective of this paper

1 The objective of this paper is to obtain Board feedback and decisions regarding whether any ***additional guidance*** and illustrative examples are required in AASB 10XX in relation to accounting for perpetual endowments. Issues addressed in this paper are as follows:

(a) control of perpetual endowments (debit):

(i) control of the asset (AASB 10XX), including type of asset – cash or right to income;

(ii) assets in a corporate structure (AASB 10);

(iii) implications of AASB 9 for perpetual endowments that are financial assets; and

(b) accounting for the timing of revenue recognition for perpetual endowments (credit), that is, when perpetual endowments would be within the scope of AASB 15 or AASB 10XX. Specifically:

(i) Is the transaction in the course of the ordinary activities of the not-for-profit entity?

(ii) Are there enforceable obligations?

(iii) Do those obligations require the entity to transfer goods or services to a customer?

2 To assist with analysis, AASB staff have developed the following base example:

A university is bequeathed 2,000,000 CU to provide a scholarship, in perpetuity for two students undertaking their final year of a medical degree. The initial donation of 2,000,000 CU is to be invested and only the income therefrom may be applied to fund the scholarships.

The table below summarises the potential accounting outcomes analysed in this paper:

Potential accounting outcomes

	CREDIT (paragraphs 61-83)	
	In scope of AASB 15 A performance obligation to use its asset to fund a scholarship in perpetuity.	**In scope of [draft] AASB 10XX** No performance obligation attaching to the asset recognised by the university
DEBIT (paragraph 25-60) **Control of the principal sum**	**Outcome 1 -** Depending on facts and circumstances, the performance obligation may be satisfied on investing the principal sum. Alternatively, the university may never be able to satisfy its performance obligation. ***Initial recognition*** DR Cash 2,000,000 CU CR Liability 2,000,000 CU *Subsequent to initial recognition* Depending on facts and circumstances, a liability is recognised in perpetuity with no revenue recognised.	**Outcome 2 -** Required by the terms of the bequest to use the investment income to fund the scholarship for that year. The obligation is not a performance obligation to use its asset (the principal sum of the bequest) to fund a scholarship in perpetuity. ***Initial recognition*** DR Cash 2,000,000 CU CR Income 2,000,000 CU
Control of the right to income	**Outcome 3 -** The obligation is a performance obligation to use the investment income in a particular way and that requirement attaches to the right to income. ***Initial recognition*** DR Right to income 2,000,000 CU CR Liability 2,000,000 CU *Subsequent to initial recognition* Depending on facts and circumstances, revenue is recognised when the investment income is used to fund the scholarship in that year.	**Outcome 4 -** Required by the terms of the bequest to use the principal sum as a perpetual endowment. The university's obligation is not a performance obligation to use its asset (the right to income). There is no performance obligation attaching to the asset recognised by the university (the right to income). ***Initial recognition*** DR Right to income 2,000,000 CU CR Income 2,000,000 CU

Background

Feedback received to date

3 At the September 2015 AASB meeting, staff provided the Board, in Agenda Paper 14.2 with an overview of comment letters received to ED 260. The paper highlighted constituent concerns about the accounting for perpetual endowments. Constituents also requested additional guidance and examples of accounting for bequests.

4 At the Income of Not-for-Profit Entities roundtables held in June 2015, constituents raised the issue as to whether the recipient of a donation/bequest that creates a perpetual endowment:

(a) controls the perpetual endowment; and

(b) can fulfil any attached performance obligations because of the requirement for the principal sum to be maintained in perpetuity.

5 Some respondents to ED 260 expressed the view that as the principal sum is required to be maintained in perpetuity,[1] the donation is therefore deferred forever as a contract liability because the performance obligations of an asset that is a perpetual endowment can never be met. Some respondents expected that the interest from investing the principal sum would be recognised as revenue as the annual interest is received along with an expense for the costs associated with satisfying the object of the endowment. Some perpetual endowments require that the "real" value of the principal sum is maintained in perpetuity. It is the expectation of constituents familiar with a perpetual endowment of this type that on investing the principal sum a part of the annual interest received would forever be a contract liability.

6 The scope of AASB 15 includes all contracts with customers to provide goods or services in the ordinary course of business, except for contracts that are specifically excluded by AASB 15 paragraph 5. A not-for-profit entity on recognising an asset in relation to a perpetual endowment is not specifically precluded from applying the accounting treatment specified in AASB 15. For example, the relationship of a university that receives from the executor of a deceased estate a principal sum to be used according to the testator's wish to provide a scholarship in perpetuity for students undertaking the final year of a medical degree could be a vendor- customer relationship.

ED 260 proposals

7 ED 260 includes the following requirements in relation to control of an asset [*emphasis added*]:

> **11 When an entity obtains control of a resource, except for a volunteer service (see paragraphs 19-24), the resource shall be recognised as an asset if:**

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[1] Only the interest from investing the principal sum is to be used to fund in perpetuity the object of the endowment.

(a) it is probable that the future economic benefits associated with the asset will flow to the entity; and

(b) the fair value of the asset can be measured reliably.

…

13 Control of an asset arises when the entity can *direct the use of, and obtain substantially all of the remaining benefits from*, *the asset*. Paragraph 33 of AASB 15 provides guidance on the benefits that can be obtained from an asset.

14 The *ability to deny or regulate the access of others to the benefits of an asset* is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. In the public sector, governments exercise a regulatory role over certain activities, for example financial institutions. This regulatory role does not necessarily mean that such regulated items meet the definition of an asset of the government that regulates those activities.

15 Transactions expected to occur in the future do not in themselves give rise to assets – hence, for example, an intention to levy a tax does not give rise to an asset in the form of a present right against a taxpayer.

8 ED 260 provides limited guidance on bequests (see paragraph 9 below) but does not provide specific guidance on endowments, perpetual or otherwise. In some circumstances, endowments arise from bequests but they can also result from donations.

9 ED 260 Appendix B includes the following guidance in relation to bequests:

AG8 A bequest is a transfer made according to the provisions of a deceased person's Last Will and Testament (Will). Bequeathed items are recognised as assets when:

(a) the entity has obtained a present legal right to, and therefore control of, the bequeathed items. This occurs when probate has been granted and, depending on the facts and circumstances, either the period for challenging the Will has expired or the Will has been challenged and it is legally determined that the entity is entitled to particular assets or amounts;

(b) it is probable that the future economic benefits will flow to the entity; and

(c) the fair value of the assets can be measured reliably.

AG9 Assessing the probability of an inflow of future economic benefits may be problematic if a period of time elapses between the entity obtaining a present legal right to bequeathed items and receiving any assets. The entity shall assess whether the deceased person's estate is sufficient to meet all claims on it, and satisfy all bequests. Whether the initial recognition of bequeathed items as assets simultaneously gives rise to the recognition of income will depend on whether a liability of the entity arises from the bequest (for example, the entity has a performance obligation under a contract with a customer, to be accounted for in accordance with AASB 15, because the Will requires the entity to use bequeathed items in a particular manner that is sufficiently specific to be able to determine when the performance obligation is satisfied [FN]).

[FN] See the guidance on a 'sufficiently specific' promise to transfer a good or service to a customer, in paragraphs IG13–IG17 of 'Appendix E [for AASB 15]' in Part A of this Exposure Draft. Bequests are discussed in this [draft] Standard, because bequests typically would not give rise to performance obligations and therefore typically would not occur in contracts with customers. For bequests involving performance obligations (eg a hospital's obligation to use bequeathed funds to finance the construction of a new wing of a building), AASB 15 would apply and the customer would be the trustee of the deceased estate, acting on behalf of the deceased person.

Requirements of other Australian Accounting Standards relating to control

10 Control is not defined in the existing suite of accounting standards, however, a number of standards specify how an entity assesses when it gains control of an asset. The control requirements in these standards are set out below.

11 AASB 10 *Consolidated Financial Statements* provides requirements on how to assess if an investor has control of an investee. However, these requirements are in regards of control of another entity and not an individual asset. In relation to ED 261 *Service Concession Arrangements – Grantor* the Board discussed whether the concept of control in AASB 10 could be used by analogy for control of a service concession asset but decided (as noted in paragraph BC13) "that the assessment of control for an entity may not, in certain circumstances, be appropriate when applying the principles to an individual asset". Therefore, for this reason, the assessment of control in AASB 10 will not be considered in this paper in regard to control of a perpetual endowment per se.

12 However, the AASB 10 concept of control is considered in paragraphs 42-49 below regarding circumstances whereby the perpetual endowment is held by a trustee and whether the entity has control of that trustee.

13 AASB 15 *Revenue from Contracts with Customers* paragraph 33 states:

> Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:
>
> (a) using the asset to produce goods or provide services (including public services);
>
> (b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

14 AASB 16 *Leases* provides application guidance on when a customer gains control of an identified asset. Paragraph B9 requires that a customer has both the following:

(a) the right to obtain substantially all of the economic benefits from use of the identified asset; and

(b) the right to direct the use of the identified asset.

15 AASB 116 *Property, Plant and Equipment* only makes reference to control in the context of when an entity should derecognise an asset, that is when a recipient gains control of an item, and cross-references to AASB 15 for the requirements that must be satisfied.

16 AASB 138 *Intangible Assets* expresses a principle regarding control that is similar to that in AASB 15 in that paragraph 13 states: "an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits".

17 Although AASB 15, AASB 16 and AASB 138 differ slightly in assessing control, the commonality in these standards suggest that control is acquired when the entity:

(a) has the ability to direct the use of a resource;

(b) receives (substantially all the remaining) economic benefits from the resource; and

(c) can restrict others from the benefits that arise from the resource.

18 At the 18 May 2016 Project Advisory Panel (PAP) teleconference, panel members agreed with the discussion on control of an asset in existing standards (excluding control of an asset in ED 261 see paragraph 19 below) and did not consider any further accounting standards that would be relevant in the context of control.

19 ED 261 *Service Concession Arrangements* includes a specific notion of control of an asset[2] that may result in some assets not being recognised unless another standard is applied. To acknowledge this situation paragraph BC17 of this exposure draft, in part, states: "The AASB notes that a broader concept of control currently applies in other

[2] ED 261 paragraph 8(a) proposes the specific control concept as:
The grantor controls the asset if, and only if:
(a) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
(b) the grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement

Australian Accounting Standards and that an asset that does not meet the control and regulation definition of this Standard may still need to be recognised under other accounting Standards".

20 Staff have differing views on whether a similar paragraph to that of BC17 in ED 261 should be included in AASB 10XX. One staff view is that because the control requirements in ED 260 are broad and not specific as in ED 261, a similar paragraph is not warranted. However, the alternate staff view is that it acts as a signpost for entities to consider other standards when assessing control of an asset.

Question for Board Members

Q1 Do Board members consider that a paragraph similar to that in ED 261 paragraph BC17 should be included in AASB 10XX?

Definition of perpetual endowment

21 Staff have reviewed the ACNC website and taxation legislation and were unable to find a definition of 'endowment', but have noted the definitions of 'endowment' in the following accounting literature:

Canada - CPA Canada Accounting Standards

An **endowment contribution** is a type of restricted contribution subject to externally imposed stipulations specifying that the resources contributed be maintained permanently, although the constituent assets may change from time to time.

United Kingdom Charity SORP

Endowment funds are resources received by the charity that represent capital. A feature of endowment funds is that charity law requires the trustees to invest it or to retain and use it for the charity's purposes. The term endowment applies to permanent endowment, where the trustees have no power to convert it into income and apply it, and to expendable endowment where the trustees do have this power.

United States – Financial Accounting Standards Board (FASB)

Endowment fund – An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit entity (NFP). The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide either of the following:

(a) A permanent endowment, which is to provide a permanent source of income

(b) A term endowment, which is to provide income for a specified period.

Alternatively, a NFP's governing board may earmark a portion of its unrestricted net assets as a Board-designated Endowment Fund.

22 Drawing on the definitions in paragraph 21 and, for the purposes of this paper, – a perpetual endowment is considered to be:

Resources (cash or other assets) donated to an entity for the ongoing support of the entity's objectives. A perpetual endowment is commonly made with the requirement that the principal be retained at real value and income earned from the principal is used for a specified purpose into perpetuity.

23 The PAP agreed with this description of a perpetual endowment.

24 Appendix A illustrates an example of a perpetual endowment that was established from a donation made in 1893 (£1,000 initial principal made up of £752 donation and £248 contribution from the University) and continues to be available to Arts students at the University of Melbourne as a $5,000 per annum scholarship.

CONTROL OF THE ASSET (DEBIT)

Staff analysis

25 In determining whether an entity has control of an endowment, there are a number of aspects that should be considered, including whether:

(a) the resource meets the control requirements in AASB 10XX;

(b) an entity has control of the resource depending on the structure of the arrangement (i.e. is the resource held by a trustee); and

(c) implications of AASB 9 *Financial Instruments* if the resource is a financial asset

Control of the asset (AASB 10XX guidance)3

Direct the use of the resource

26 In the absence of specific guidance in ED 260 the issue of whether an entity is able to direct the use of the resource for a perpetual endowment has arisen. Note that each donation/bequest can have different stipulations and conditions therefore it would be necessary for each entity to examine the facts and circumstances attached to donation/bequests to assess whether they have control of the asset.

27 Staff are aware of three predominant views:

View 1: Because the entity is restricted from using the principal sum of the endowment the entity it is not able to direct the use of that resource (being the principal sum) and therefore, no asset would be recognised. Interest income generated on the principal sum would be recognised in accordance with the requirements of AASB 15.

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[3] For the purposes of this section (paragraphs 26 –41) control of an asset will be applied as a general concept, even though the asset discussed is a financial asset. Whether AASB 9 creates implications for perpetual endowments that are financial assets is discussed at paragraphs 50 –60.

View 2: Although the entity does not have control over the principal sum because of the restrictions attached to it, an entity may have an asset of the right to receive income (being the interest generated from the principal sum, see paragraph 49) for which it can direct the use (i.e. by deciding scholarship recipients). Therefore, the present value of future cash flows may be recognised as a financial asset.

View 3: The entity is able to direct where the resources are invested and are also able use the resources for furthering its objectives, so is able to direct the use of the resource. An asset is recognised for the principal sum (if it meets the other control criteria).

28 The PAP was only presented with Views 1 and 3 and agreed with View 3. Staff agree with Views 2 and 3 and recommend that to help address this issue the guidance in AASB 16 may be useful for entities to be able to assess whether they have the ability to direct the resources. For example, AASB 16 paragraph B24(b)(i), notes that if relevant decisions about how and for what purpose the asset is used are predetermined, and if the customer has the right to operate the asset, without the supplier having the right to change those operating instructions, then the customer has the right to direct the use of that asset.

29 Using this guidance by analogy to the example in paragraph 26 above, it may be argued that the restriction on using the bequest is predetermined but the university has the ability to decide where the donation is invested to provide income which can be used, and who the recipients of the scholarships are, therefore in this scenario the university has the ability to direct the use of the resource.

30 Consequently staff recommend including additional guidance in the final Standard, along the following lines:

> If relevant decisions about how and for what purpose the asset is used are predetermined, and if the customer has the right to operate the asset, without the supplier having the right to change those operating instructions, then the customer has the right to direct the use of that asset.

Questions for Board Members

Q2 Does the Board agree with the staff view that in regards to perpetual endowments, an entity is able to direct the use of either the principal sum or a right to receive income?

Q3 Does the Board agree that additional guidance regarding ‘directing the use’ of perpetual endowments should be included in the AASB 10XX?

Obtain substantially all the benefits

31 In the absence of specific guidance in ED 260 the issue of whether an entity is able to obtain substantially all the benefits has also arisen in relation to perpetual endowments. In particular, identifying what the benefits are.

32 The Basis for Conclusions to AASB 15 paragraph BC120(c) states: "Conceptually, the benefits from a good or service are potential cash flows (either an increase in cash inflows or a decrease in cash outflows). A customer can obtain the benefits directly or indirectly in many ways, such as by using, consuming, disposing of, selling exchanging, pledging or holding an asset".

33 AASB 16 provides guidance on the concept of 'substantially all'. Paragraph B22 states: "when assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset".

34 In addition, the *Framework for the Preparation and Presentation of Financial Statements* at paragraph Aus49.1 states that in the not-for-profit sector (future) economic benefits is synonymous with the notion of service potential. Service potential is not defined in AASB literature but is described in *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* issued by the IPSASB as "the capacity to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows".

35 Staff are aware of two predominant views:

View 1: An entity does not receive substantially all of the benefits because of the restriction attached to the principal sum of the donation/bequest in that it cannot be used for any other purpose other than that specified by the donor. In the University example provided in paragraph 2 the restriction in use of the principal sum would mean that it does not meet the 'substantially all of the benefits' requirement.

View 2: An entity does receive substantially all of the benefits as the perpetual endowment enables the entity to receive future economic benefits/service potential by furthering its objectives. No other entity is able to receive the future economic benefit/service potential of the principal sum. For example, in the above scenario, an objective of the university would include providing education. Therefore, the perpetual endowment enables the university to receive future economic benefits/service potential and further it objective of providing education to students via the scholarships awarded.

36 The PAP and staff both agree with View 2 and recommend that to help address this issue the guidance in AASB 15 and AASB 16 may be useful for entities to be able to assess whether they have substantially all of the benefits.

37 Applying this guidance to the example in paragraph 2 above, it may be argued that the defined scope of the terms attached to the donation are that only the interest from investing the principal sum can be used to fund two scholarships. Consequently, the university receives all the future economic benefits/service potential that are within this defined scope, thus meeting the 'substantially' all hurdle.

38 Staff recommend including additional guidance in the final Standard along the following lines:

One element that indicates an entity has control of an asset is its ability to obtain substantially all the remaining benefits of the asset. For not-for-profit entities, these benefits may be the economic benefits or service potential remaining in the asset. In relation to perpetual endowments, often the asset (the principal sum) may be restricted in how the entity can use it for example an entity may be restricted from using the principal sum of the donation/bequest which established that perpetual endowment and may only be able to use income derived from investing that principal sum. When assessing whether an entity can obtain 'substantially all the remaining benefits 'of a restricted asset, the entity shall consider the economic benefits or service potential that result from the use of the asset in its restricted form.

Questions for Board Members

Q4 Does the Board agree with the discussion above, and View 2, that an entity that is the recipient of a perpetual endowment is able to obtain substantially all the benefits associated with that endowment?

Q5 Does the Board agree that additional guidance regarding 'obtaining substantially all the benefits' should be included in AASB 10XX?

Restrict others access to the benefits

39 Staff are not aware of any specific issues raised in relation to restriction of access to the benefits of a perpetual endowment asset.

40 In the example in paragraph 2 the university is the sole beneficiary of this donation and as expressed in paragraph 35 (View 2) above, the benefits that arise from this perpetual endowment are the future economic benefits/service potential associated with furthering the university's objective of providing education. Therefore, because the scholarships that further this objective are particular to the university no other entity has access to those benefits.

41 The PAP did not raise any issues in regards to restricting others access to the benefits associated with perpetual endowments.

Question for Board Members

Q6 Does the Board agree that an entity that is the sole beneficiary of a donation/bequest that creates a perpetual endowment is able to restrict others access to the benefits, this being the future economic benefits/service potential associated with furthering the entity's objectives?

Assets in a corporate structure

<u>Control re the structure of the arrangement</u>

42 This section of the paper (paragraphs 42 –49) discusses whether control of a perpetual endowment differs depending how the endowment is held.

43 Perpetual endowments are commonly held and administered by a trustee, therefore staff have identified three structures in which perpetual endowments may be held. The endowment is held with:

(a) the entity to which the donation/bequest was made;

(b) a trustee associated with the entity to which the donation/bequest was made; or

(c) a trustee external to the entity to which the donation/bequest was made.

<u>Entity holds the perpetual endowment</u>

44 In regards to the first arrangement at paragraph 43(a)this is an issue of control of the principal sum, rather than control of another entity (which is addressed in below), therefore the analysis in paragraphs 26-41 above applies.

<u>Trustee hold the perpetual endowment (paragraphs 43(b) and 43(c))</u>

45 A trustee commonly holds a perpetual endowment and that trustee distributes to the entity income earned from that perpetual endowment which is then used for a specific purpose.

46 If a perpetual endowment is held and administered by a trustee, the reporting entity would recognise an asset (the perpetual endowment) if it controlled the trustee and prepared consolidated financial statements. Therefore, an entity would need to apply the three requirements in AASB 10 to determine if it had control over the trustee.

47 These requirements (paraphrased from AASB 10 paragraph 7) are the entity has:

(a) power over the trustee;

(b) exposure, or rights, to variable returns from its involvement with the trustee; and

(c) the ability to use its power over the trustee to affect the amount of the trusts returns.

48 Staff are of the view that assets within a corporate structure would be outside the scope of AASB 10XX as they are dealt with by AASB 10.

49 If the principal sum is held with a trustee the entity will have to determine the nature of the asset that can be recognised. If the entity controls the trustee then the asset recognised may be the principal sum. However if the entity does not control the trustee there may be another asset, being the present value of the future cash flows. Recognition will depend on the facts and circumstances of each situation, and for trustees that are not controlled, matter an entity will have to consider include, whether they have a contractual right to receive the cash flows and whether or not they are the sole beneficiary of the income derived from the principal sum. Entities that are not sole beneficiaries may have difficulties placing a valuation on the cash flows.

Question for Board Members

Q7 Do you agree with the staff view that assets within a corporate structure are outside the scope of AASB 10XX as they are dealt with by AASB 10? If not, how should such structures be accounted for?

Q8 If you agree that these structures are within the scope of AASB 10, do you think any additional guidance is required in AASB 10 in relation to perpetual endowments? Alternatively, do you think application guidance illustrating when an entity controls a trustee directing preparers to AASB 10 should be included in AASB 10XX?

Implications of AASB 9 for perpetual endowments that are financial assets

50 The discussion to date has intended to be conceptual and able to be applicable to any type of resource, regardless of its form. However, it may be argued that because a cash donation is a financial asset it may have different requirements in regards to the derecognition criteria of a financial asset.

51 AASB 132 *Financial Instruments: Presentation* paragraph 11 (in part) states:

A financial asset is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right;

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity …

52 Therefore, for those donations/bequests that are in the form of cash, regardless of the structure in which is held, staff are of the option that a financial asset exists, this being either cash or a contractual right to receive cash flow.

53 AASB 9 *Financial Instruments* paragraph 3.2.3 requires that an entity derecognise a financial asset when, and only when:

(a) the contractual rights to the cash flows from the financial asset expire, or

(b) it transfers the financial asset as set out in paragraph 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6.

54 Paragraph 3.2.4 states: an entity transfers a financial asset if, and only if it either:

(a) transfers the contractual rights to receive the cash flows of the financial asset, or

(b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 3.2.5.

55 Paragraph 3.2.5 elaborates on part (b) of paragraph 3.2.4 by stating: "when an entity retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), the entity treats the transaction as a transfer of financial asset if, an only if three conditions are met.

(a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term, advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rated do not violate this condition.

(b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.

(c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to invest such cash flow, except for investments in cash or cash equivalents (as defined in AASB 107 *Statement of Cash Flows*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients".

56 Paragraph 3.2.6 requires that when an entity transfers a financial asset (paragraph 3.2.4) it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

(a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

(b) if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.

(c) if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case;

(i) if the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

(ii) if the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset.

57 Using the example in paragraph 2 staff are aware of two predominant views:

View 1: Because the entity is required to use the income derived from the principal sum to fund scholarships, this is a 'contractual obligation to pay those cash flows to one or more entities (the eventual recipients)' (i.e. the scholarship recipients), and the three conditions in paragraph 3.2.5 are met. Therefore, the entity has transferred the financial asset and as such, it should be derecognised.

View 2: Even though the entity is required to fund scholarships with the income derived from the principal sum, there is no contract with the 'eventual recipients' (i.e. the scholarship recipient). Therefore, the financial asset has not been transferred and the derecognition criteria has not been met, consequently the entity should continue to recognise the financial asset.

58 Staff agree with View 2 that there is no contract with the scholarship recipients because until these recipients are awarded the scholarships they would have no claim on the entity for payment of that cash flow. Further, the scholarship recipient would only have claim on the cash flow for that scholarship period and no future cash flows beyond this period – these will go to future scholarship recipients.

59 In addition, staff consider that for entities that control the principal sum (i.e. not held with a trustee) and are depending on investment decisions to give rise to sufficient income to meet the terms of the donation/bequest, the risks and rewards of that financial asset remain with the entity and therefore should continue to be recognised as a financial asset (AASB 9 paragraph 3.2.6(b)).

60 Staff recommend that no extra guidance be included in AASB 10XX in regards to derecognition of perpetual endowments that are financial assets. Staff consider that entities that have perpetual endowments that are financial assets would already be applying AASB 9 requirements and including guidance that concludes that the financial asset would remain recognised may be confusing.

Question for Board Members

Q9 Does the Board agree with the Staff and View 2 that there is no contract between the entity and scholarship recipients for the contractual cash flows associated with the principal sum and therefore the associated financial asset would not need to be derecognised?

Q10 Does the Board agree with the staff recommendation that no extra guidance should be included in AASB 10XX in regards to perpetual endowments that are financial assets?

Question for Board Members:

Q11 Are there any other issues Board members would like to raise in relation to control of perpetual endowments?

TIMING OF REVENUE RECOGNITION (CREDIT)

Staff analysis

61 If the Board agrees with the previous section of this paper that there is an asset (principal sum or right to income) that is recognised in relation to a perpetual endowment, this section will address the "credit" side of the transaction of when revenue is recognised.

62 Staff have identified three key decision points for whether AASB 15 or the revenue recognition requirements of AASB 10XX apply:[4]

(a) Is the transaction in the course of the ordinary activities of the not-for-profit entity?

(b) Are there enforceable obligations?

(c) Do those obligations require the entity to transfer goods or services to a customer?

63 AASB 15 applies when each of the key decision points is answered in the affirmative.

64 Applying this to the example in paragraph 2 above, when AASB 15 applies, the amount at which the asset is measured on initial recognition is allocated against the university's performance obligations and revenue is recognised as a performance obligation is satisfied. The presence of unsatisfied performance obligations means there is a deferral of revenue until performance obligations are met. In contrast, when [draft] AASB 10XX applies, there is immediate recognition of revenue.[5]

Is a donation/bequest in relation to a perpetual endowment part of ordinary activities?

65 If a donation/bequest in relation to the perpetual endowment is not part of the ordinary activities the not-for-profit entity will on recognising an asset for the donation/bequest immediately recognise revenue ([draft] AASB 10XX).

66 AASB 15 does not define the term 'ordinary activities' and it is not a defined term in the current IASB, IPSASB or AASB literature.

67 The term 'ordinary activities' is used in the *Framework for the Preparation and Presentation of Financial Statements*. For example, the Framework paragraph 72 "Items that arise from the ordinary activities of one entity may be unusual in respect of another.". The implication is that revenue is derived from an entity's core activities.

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4 Note that Agenda Paper 3.3 addresses capital grants and includes a discussion of the three decision points and that discussion is also relevant here.

5 If in obtaining the bequest a liability was incurred, the amount of the liability would be deducted from the asset to measure revenue.

68 Staff outreach[6] identified support for the view that obtaining a donation/bequest that creates a perpetual endowment is part of ordinary activities of a not for profit entity. A different view was not expressed.

69 The Panel in their discussions with staff on this decision point expressed a view that was consistent with that identified in Staff outreach. .

Staff view

70 Staff support the view identified in staff outreach that receiving a perpetual endowment is part of ordinary activities of a not-for-profit entity.

Question for Board Members:

Q12 Do Board members agree with the staff view that obtaining a donation/bequest that is a perpetual endowment is part of the ordinary activities of a not-for-profit entity?

Is a donation/bequest in relation to a perpetual endowment enforceable?

71 If a donation/bequest in relation to a perpetual endowment is not enforceable the not-for-profit entity will immediately recognise revenue ([draft] AASB 10XX).

72 The [draft] Implementation Guidance to AASB 15 paragraph IG3 states "An inherent feature of a contract with a customer is that the [not-for-profit] entity makes promises in an agreement that creates enforceable rights and obligations.". Paragraph IG5 provides guidance for when an agreement creates enforceable obligations through legal or equivalent means. Examples provided include:

(a) a right to specific performance; and

(b) a return obligation.

73 Paragraph IG6 notes that "Enforceability depends solely on the customer's capacity to enforce its rights.".

74 Staff discussions with lawyers experienced in the operation of "perpetual endowments" and some not-for-profit entity recipients lead staff to consider that there will be situations where the donation/bequest related to a perpetual endowment is enforceable.

75 The view was expressed by participants in their discussions with staff that the operation of law can be different depending on how the donation/bequest is received and /or its terms. For example, when the principal sum has been settled in a charitable trust, the Attorney-General is the person who can seek recourse against the Trustee. We were told that "receipt and discharge" and "gift over" clauses are used in some donations/bequests. Entities that receive donations/bequests related to a perpetual

6 Staff outreach included discussions of this point with lawyers experienced in the operation of bequests and donations of a principal sum that is a perpetual endowment and some not-for-profit entity recipients.

endowment would need to examine how it is received and/or the conditions attached to the donation/bequest to make their assessment of enforceability.

Staff view

76 Staff are of the view that, consistent with the Board's previous decisions, the presence of a return obligation for failing to transfer promised goods/services or a right to enforce specific performance makes the agreement enforceable, key indicators that the donation/bequest in relation to a perpetual endowment are the existence of refundability or a right to specific performance. For example, the donation/bequest to provide a scholarship, in perpetuity for two students undertaking their final year of a medical degree has a refund obligation if the donation/bequest is not spent for this purpose.

77 Staff are of the view that the features described in paragraph 72 above will be present in some agreements. Feedback received indicates that for donations/bequests in relation to a perpetual endowment enforceability is a matter of facts and circumstances

Question for Board Members:

Q13 Do Board members agree with the staff view that a refund obligation and a right to specific performance are key indicators of enforceability for a donation/bequest that is related to a perpetual endowment? Are there any further indicators that Board members think staff should consider?

Does the donation/bequest in relation to a perpetual endowment require that the entity transfer goods and/or services

78 The fact that a donation/bequest in relation to a perpetual endowment is part of the not-for-profit entity's ordinary activities and is enforceable may not necessarily mean that the not-for-profit entity is required to transfer goods and/or services to a customer. In the absence of a transfer of goods/services the not-for-profit entity will immediately recognise revenue ([draft] AASB 10XX).

79 AASB 15 paragraph 22 requires that an entity shall identify as a performance obligation, each promise to transfer to the customer goods or services.

80 Under AASB 15 an entity recognises revenue as performance obligations are satisfied (paragraph 46). A performance obligation can be satisfied over time if an entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. The [draft] Implementation Guidance to AASB 15 paragraph IG13 provides guidance for not-for-profit entities identifying a performance obligation in respect of a promise to transfer goods or services. When (or as) the performance obligations are satisfied revenue is recognised.

81 Staff discussions with some not-for-profit entity recipients identified support for the view that on obtaining a donation/bequest that creates a perpetual endowment (e.g., to provide a scholarship, in perpetuity for two students undertaking their final year of a medical degree), the not-for-profit entity has promised to transfer goods/services. A different view was not expressed.

Staff view

82 Staff support the view identified in staff outreach. Therefore, staff are of the view that, on recognising an asset for a donation/bequest related to a perpetual endowment, a not-for-profit entity has promised to transfer to the customer goods or services.

Question for Board Members:

Q14 Do Board members agree with the staff view that a donation/bequest related to a perpetual endowment will involve a transfer of goods/services to a customer?

Question for Board Members:

Q15 If Board members agree with the staff views in question 12, 13 and 14 that not-for-profit entity donations/bequests in relation to a perpetual endowment that is (a) within ordinary activities, (b) enforceable and (c) involve the transfer of goods and/or services, the donation/bequest is within the scope of AASB 15?

Staff recommendation

83 Staff recommend including in the final Illustrative Examples a "perpetual endowment" example that reflects the Board decisions on the Table that follows paragraph 2 above. Staff recommend that the illustrative example is developed using the base example presented in paragraph 2 above. Staff do not recommend the inclusion of guidance on "perpetual endowments" as the material proposed in ED 260, including the key indicators of enforceability, is adequate.

Question for Board Members:

Q16 Do Board members agree with the staff recommendation to include in the final Illustrative Examples a "perpetual endowment" example that reflects the Board decisions on the Table that follows paragraph 2 above? If so, do Board members agree with the staff recommendation that the illustrative example is developed using the base example presented in paragraph 2 above? Do Board Members agree with the staff recommendation to not include guidance on "perpetual endowments" as the material proposed in ED 260, including the key indicators of enforceability, is adequate?

Question for Board Members:

Q17 Are there any other issues Board members would like to raise in relation to the timing of revenue recognition of perpetual endowments?

Appendix A
Shakespeare Scholarship

Recitals-

A. In 1863 a group of prominent citizens in the Colony of Victoria commenced an appeal to raise funds to commemorate the tercentenary of Shakespeare's birth the following year principally by means of scholarships.

B. In 1866 the University Council agreed to accept the £752 collected and to establish a scholarship in Shakespeare's honour.

C. The University contributed £248 to ensure the sum available to endow the scholarship was £1,000, the original aim of the citizens group.

D. The present capital amount is $22,814.

It is provided as follows-

1. The sum of $22,814 forms a fund known as the "Shakespeare Scholarship" ("the fund") and any accumulations of or additions to the sum must be paid into the fund and the fund must be paid into an investment pool and must remain there until the Council directs otherwise.

2. The net annual income of the fund is to be used to provide a scholarship called the "Shakespeare Scholarship" ("the scholarship") to be awarded from time to time by the Council on the recommendation of the dean of the faculty of Arts ("the dean").

3. Persons eligible to apply for award of the scholarship are-

   (a) students enrolled in the course for the degree of bachelor of Arts who are undertaking a Second, Third or Fourth Year English subject, and

   (b) persons who have qualified not more than one year previously for the degree of bachelor of Arts (ordinary degree) with a major in English.

4. The scholarship is awarded to the person who submits the best essay, in the opinion of the English department board of examiners, on the subject of Shakespeare.

5. Notices calling for registrations of intention to compete for the scholarship and advising details are to be placed on faculty of Arts and English Department noticeboards by the first teaching day in the second semester each year. Applicants for the scholarship must submit completed essays by the date specified in the notice.