Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Income of Not-for-Profit Entities**	**Meeting**	AASB June 2016 (M152)
Topic:	**Capital grants**	**Agenda Item:**	3.3
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Introduction and objective of this paper

1 The objective of this paper is to obtain Board feedback and decisions in relation to capital grants as to whether:

(a) additional guidance is necessary to clarify the concepts of principal and agent;

(b) the resulting revenue is accounted for under AASB 15 *Revenue from Contracts with Customers* or [draft] AASB 10XX *Income of Not-for-Profit Entities*; and

(c) the Illustrative Examples should include an example of a capital grant transaction.

2 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 3)

(b) Background – (paragraphs 4-7)

(c) Feedback received on capital grants (paragraph 8-11)

(d) Staff analysis, recommendations and questions for the Board (paragraphs 12-43)

(e) Appendix: Comprehensive Example of a grant to build an asset

Summary of staff recommendations

3 The staff recommend the following:

(a) not to add additional guidance to clarify the concepts of principal and agent; and

(b) to add to the Illustrative Examples a capital grants example.

Background

4 ED 260 proposed a new Standard (AASB 10XX) and accompanying material to address accounting for resources obtained by a not-for-profit entity. A not-for-profit entity will apply [draft] AASB 10XX to inflows of resources to:

(a) determine when control of the asset is obtained (i.e. accounting for "debit" side of the transaction); and

(b) provide the basis for accounting for the "credit" side of the transaction by:

(i) including 'signposts' to requirements of relevant existing Accounting Standards entities should apply, (e.g., AASB 15); and

(ii) specifying income recognition principles for transactions that are not within the scope of existing Standards.

ED 260 also proposed Implementation Guidance and Illustrative Examples to accompany AASB 15 to help a not-for-profit entity that is directed by [draft] AASB 10XX to apply that Standard.

5 A capital grant is not defined in Australian Accounting Standards or IPSASB literature – although AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* paragraph 3[1] includes definitions of government grants and grants related to assets.[2]

6 The National Standard Chart of Accounts published by the Australian Charities and Not-for-profits Commission has three definitions of capital grants:

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1 AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* does not apply to not-for-profit entities.

2 Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity. Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

- Grants (Commonwealth) – Capital,[3]
- Grants (State) – Capital,[4] and
- Grants (Local) – Capital.[5]

However, it does not include a single definition.

7 The Glossary published by Philanthropy Australia[6] defines a capital grant and capital asset as follows:

> **Capital grant**
>
> A grant made to an organisation towards a major item of capital expenditure, such as the construction of a building.
>
> **Capital asset**
>
> A capital asset is an asset of a permanent or fixed nature, such as goods, equipment, buildings and land.

For the purposes of this paper, a capital grant is defined consistently with the above definition.

Feedback received on capital grants

8 ED 260 did not specifically address the accounting treatment of capital grants and whilst constituents have not expressed particular concerns, some did express a need for a specific example.

9 Some constituents noted that as capital grants contain refund obligations they are enforceable. It was also noted that funding agreement will stipulate that the constructed item (e.g., a new educational facility or a refurbished building) must continue to be used for a minimum period; otherwise an amount is refundable using a time-basis formula.

10 Some constituents from the university sector noted that the outcome from applying the existing accounting requirements in AASB 1004 was that universities recognise a

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3 Grants (Commonwealth)-Capital: This account represents capital grants received to acquire/purchase or construct properties, upgrade or enhance existing properties, or acquire/purchase other items reported as assets such as an individual piece of equipment such as a fire truck or photocopier or a building.

4 Grants (State)-Capital: This account represents capital grants received to acquire/purchase or construct properties, upgrade or enhance existing properties, or acquire/purchase other items reported as assets.

5 Grants (Local)-Capital: This account represents capital grants received from the local authority including donated land to housing co-operatives and sporting clubs.

6 Philanthropy Australia's mission is to represent, grow and inspire an effective and robust philanthropic sector for the community

capital grant to build an educational facility, at the time of receipt. Some hold the view that this accounting treatment does not reflect the relationship of the grant and the related expenditure, with the related expenditure recognised over a number of reporting periods, as the educational facility is built. Some constituents asked whether a capital grant received to enhance an existing asset of entity is a transfer of good or service to a customer.

11 Capital grants were discussed by the Project Advisory Panel (the 'Panel'). Feedback from the Panel is incorporated into the staff analysis below.

Staff analysis, recommendations and questions for the Board

<u>Clarification of the asset recognition criteria</u>

12 ED 260 proposed that "control of an asset arises when the entity can direct the use of, and obtain substantially all of the remaining benefits from, the asset." ([draft] AASB 10XX paragraph 13). When an entity obtains control of any resource, the resource is recognised as an asset if:

(a) it is probable that the future economic benefits associated with the asset will flow to the entity;[7] and

(b) the fair value of the asset can be measured reliably ([draft] AASB 10XX paragraph 11).

13 Whether an entity is a principal or an agent is discussed in the Application Guidance to [draft] AASB 10XX, which notes that:

(a) a not-for-profit entity does not control the future economic benefits in the capital grant when it holds them in the capacity of an agent before transferring them to another party;

(b) a not-for-profit entity that is not an agent would, as the principal, control the future economic benefits in the capital grant:

(i) on receiving the resource; or

(ii) prior to receipt of the resource, if the grantor's promise to transfer the resource is legally enforceable.

14 The discussion of agent in the Application Guidance paragraphs AG15 and AG28 to [draft] AASB 10XX uses public sector scenarios.[8]

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7 [draft] AASB 10XX paragraph 17 notes "…an inflow of future economic benefits is probable when the inflow is more likely than not to occur."

8 As administered item transactions are common in the public sector this is reflected in the prevalence of some public sector entities obtaining resources as an agent.

15 Whether an entity is a principal or an agent will depend on facts and circumstances. Outreach and discussion with the Panel indicates that typically it is as a principal that a not-for-profit entity obtains the inflow of the resource that is the capital grant. Feedback from the Panel was that it would not be common for a private sector not-for-profit entity to obtain a capital grant as agent. Accordingly, staff do not recommend any additional guidance or clarification be made to the concepts of principal and agent in relation to capital grants.

Question for Board members
Q1 Do Board members agree with the staff recommendation not to add additional guidance to clarify the concepts of principal and agent?

Accounting for the "credit"

16 On recognising an asset for the capital grant either:

(a) AASB 15 or another Standard applies (e.g., AASB 1004 *Contributions* if there is a contribution by owner); or

(b) [draft] AASB 10XX applies.

17 When AASB 15 applies, the amount at which the capital grant asset is measured on initial recognition is allocated against the not-for-profit entity's performance obligations, and revenue is recognised as a performance obligation is satisfied. In contrast, when [draft] AASB 10XX applies the amount of the capital grant is immediately recognised as revenue.[9]

18 Therefore, the timing of revenue recognition by a not-for-profit entity can differ depending on the Standard applied. Under AASB 15 the presence of unsatisfied performance obligations means there is a deferral of capital grant revenue until performance obligations are met. Under [draft] AASB 10XX there is immediate revenue recognition with no deferral.

19 Staff have identified key decision points for whether AASB 15 or the revenue recognition requirements of [draft] AASB 10XX apply to the capital grants as:

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

(b) are there enforceable obligations?; and

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

If an entity fails any one of the above decision points, the capital grant is accounted for in the scope of [draft] AASB 10XX.

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

20 In the Appendix staff have developed a comprehensive capital grant example and illustrate the different timing of revenue recognition with the accounting entries for a not-for-profit entity as principal under AASB 15 and [draft] AASB 10XX. For completeness, the accounting entries for a not-for-profit entity as agent are provided.

A summary of the effects of the two standards on the different timing of revenue recognition in the accounting entries is presented in the table below here. The Appendix includes complete accounting entries under AASB 15 and [draft] AASB 10XX.

		CREDIT AASB 15	**CREDIT [draft] AASB 10XX**
DEBIT [draft] AASB 10XX	**Principal** (entity has control of inflow, recognise asset)	*Initial recognition* DR Cash CR Liability *Subsequent periods* DR Liability CR Revenue DR Asset CR Cash [See: Appendix Exhibit 1]	*Initial recognition* DR Cash CR Income *Subsequent periods* DR Asset CR Cash [See: Appendix Exhibit 2]
	Agent (entity does not control inflow, no asset to recognise)	*Initial recognition* No entry *Subsequent periods* DR Asset CR Revenue Transfer of goods/services to customer [See: Appendix Exhibit 3]	*Initial recognition* No entry *Subsequent periods* DR Asset CR Income No transfer of goods/services to customer [See: Appendix Exhibit 4]

21 The Panel discussed the comprehensive example with staff and agreed with the effects of the two standards on the different timing of revenue recognition as presented.

Scope of AASB 15

22 The scope of AASB 15 includes all contracts with customers[10] to provide goods or services in the ordinary course of business, except for contracts that are specifically

10 AASB 15 Appendix A defines a contract as "an agreement between two or more parties that creates enforceable rights and obligations." A customer is defined as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration." In addition, the transactions that are within the scope of AASB 15 must satisfy paragraph 9 of AASB 15. An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

excluded by AASB 15 paragraph 5.[11] A not-for-profit entity on obtaining a capital grant is not specifically precluded from applying the accounting treatment specified in AASB 15. For example, the relationship of a private not-for-profit preschool that receives from State Government a cash amount that is a capital grant to build a building could be a vendor- customer relationship.

Is a capital grant part of ordinary activities?

23 If a capital grant is not part of ordinary activities the not-for-profit entity will on recognising an asset for the capital grant immediately recognise revenue ([draft] AASB 10XX).

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

25 The term 'ordinary activities' is used in the *Framework for the Preparation and Presentation of Financial Statements*. For example, the Framework paragraph 72

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).

[11] An entity shall apply this Standard to all contracts with customers, except the following:

(a) lease contracts within the scope of AASB 117 *Leases*;

(b) insurance contracts within the scope of AASB 4 *Insurance Contracts*;

(c) financial instruments and other contractual rights or obligations within the scope of AASB 9 *Financial Instruments*, AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements*, AASB 127 *Separate Financial Statements* and AASB 128 *Investments in Associates and Joint Ventures*; and

(d) non-monetary exchanges between entities in the same line of business to facilitate sales to *customers* or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

"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.

26 There are different views on whether obtaining a capital grant is part of ordinary activities.

View 1: The ordinary activities of a not-for-profit entity are its objective. For example, the objective of a private sector not-for-profit preschool is to encourage in each child the development of a range of particular skills (three examples of skills are respect for themselves, others and the environment, a sense of responsibility for their actions and behaviour, and communication with those around them). Therefore, obtaining a capital grant is not part of the ordinary activities of the preschool.

View 2: A capital grant is part of ordinary activities as the objective of a not-for-profit entity should not be read narrowly. In the example above the resources required to develop skills in preschool children include access to physical resources including a building. The preschool may choose to lease the building or operate its own building. By definition, a private not-for-profit preschool is eligible to apply to government for a capital grant to build a building for the operation of a preschool program. Therefore, applying for and obtaining a capital grant is an ordinary activity of the preschool

27 The Panel in their discussion with staff on this decision point supported View 2.

Staff view

28 Staff are of the view that applying for and obtaining a capital grant is part of ordinary activities of a not-for-profit entity.

Question for Board members

Q2 Do Board members agree with the staff view that obtaining a capital grant is part of ordinary activities of a not-for-profit entity?

Is a capital grant enforceable

29 If a capital grant is not enforceable the not-for-profit entity will immediately recognise revenue ([draft] AASB 10XX).

30 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.

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

32 Staff discussions with grant making bodies and grant recipients lead staff to consider that in the main capital grants are enforceable; however, entities that receive capital grants would need to examine the conditions attached to any grants they receive to make this assessment.

The Panel in their discussion with staff on this decision point supported the view that capital grants are enforceable, typically because they include a refund obligation for amounts not spent in the appropriate period. Some respondents to ED 260 also noted that a refund obligation is a feature of grants.

Staff view

33 Staff are of the view that, consistent with the Board's previous decisions that the presence of a return obligation for failing to transfer promised goods/services makes the agreement enforceable,[12] a key indicator that a capital grant is enforceable is the existence of refundability. For example, a capital grant for the construction of a preschool early learning centre that has a refund obligation if the grant is not spent for this purpose. However, a condition of a grant such that a successful applicant is to use the grant for a particular purpose, and failure to do so will make the not-for-profit entity ineligible to receive future capital grants, is not enforceable.

34 Staff are of the view that typically a capital grant is enforceable due to the presence of a refund obligation. [draft] Appendix E of AASB 15 paragraphs IG7 andIG8 describe two circumstances that would not of themselves cause an agreement to be enforceable – a capacity to withhold future funding and a statement of intent. Staff are not aware of other circumstances and feedback received indicates that for capital grants enforceability is a matter of facts and circumstances.

Question for Board members

Q3 Do Board members agree with the staff view that a refund obligation is a key indicator of enforceability for capital grants? Are there any further indicators that Board members think staff should consider?

<u>Does the capital grant require that the entity transfer goods and/or services</u>

35 The fact that a capital grant 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).

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

37 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

12 AASB 23-24 February 2016 Agenda Paper 12.1 paragraph 43.

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.

38 There are different views on whether a capital grant involves a promise to transfer to the customer goods or services.

View 1: A capital grant received by a not-for-profit entity is used by the entity to purchase or construct a capital asset to the grantor's order. For example, a not-for-profit preschool receives a cash capital grant to construct a preschool early learning centre to the grantor's specifications. AASB 15 applies.

View 2: A capital grant received by a not-for-profit entity is used by the entity to purchase or construct a capital asset for its benefit. There is no transfer of goods/services to a customer, therefore, the capital grant is not within the scope of AASB 15, [draft] AASB 10XX applies.

39 Those who support View 1 would see the preschool on obtaining control of the cash and recognising an asset, applying AASB 15 and recognising revenue as it satisfies its performance obligations (i.e., recognise revenue over time as the building is constructed). As the preschool spends the cash to build the building it controls the work-in-progress at that time and recognises an asset.

40 Those who support View 2 do not support the logic that underlies View 1, it is not consistent with the fact that the preschool builds the building for its own use.

41 The Panel noted that most capital grants would involve the transfer of resources and, as such, be within the scope of AASB 15.

Staff view

42 Staff support View 1 that on recognising an asset for a capital grant the not-for-profit entity has promised to transfer to the customer goods or services. Staff are of the view that a capital grant that is part of ordinary activities and enforceable will involve a transfer of goods/services to a customer and is therefore within the scope of AASB 15.

Question for Board members

Q4 Do Board members agree with the staff view that a capital grant will involve a transfer of goods/services to a customer?

Question for Board members

Q5 If Board members agree with the staff views in question 2,3 and 4 that NFP entities capital grants are (a) ordinary activities, (b) enforceable and (c) involve the transfer of goods and/or services, the grants are within the scope of AASB 15?

43 Staff recommend including in the final Illustrative Examples a capital grant example – specifically an example that is focused on a cash capital grant received by a private sector not-for-profit entity as principal to build a building. An illustrative example of

this type would be representative of a facts and circumstances that are found in capital grant transactions. Staff recommend that the example be the comprehensive example presented in the Appendix applying AASB 15 (i.e., the accounting entries presented in Exhibit 1).

Question for Board members

Q6 Do Board members agree with the staff recommendation to add a capital grants example? If so, do Board members agree with the staff recommendation that the example be the comprehensive example presented in the Appendix applying AASB 15 as principal?

Appendix: Comprehensive Example of a grant to build an asset

1 On 1 July 20X1, a private sector not-for-profit preschool receives from a State Government a cash grant of $2m to build and commission a new two-room early learning facility on the not-for-profit entity's land to the standard specified by government department regulations applicable to preschool programs for children in the year before school.

The facility must include two rooms for the delivery of preschool programs. The project must be completed within 24 months of the execution of the funding agreement. The not-for-profit entity must return all unspent money and uncommitted funding after commissioning of the facility. The not-for-profit entity is liable to reimburse the Government the whole or portion of the grant amount (calculated on a pro-rata basis) if the facility ceases to be used for the provision of preschool services before ten years after the date on which the funds have been fully paid.

The State Government separately provides the not-for-profit entity a cash grant for each eligible child who is enrolled and attending the preschool program as a contribution toward the cost of running the program.

The not-for-profit entity's financial year ends 30 June.

At the end of the first year, the project was 60 percent complete (and $1.2m spent). The facility was commissioned on 1 April 20X3 and the $2m was fully spent.

Exhibit 1 As principal, recognise revenue from the grant (apply AASB 15)

Financial year ended 30 June 20X2			30 June 20X2	
01/07/X1	Dr Cash Cr Contract Liability	$2m $2m	INCOME STATEMENT	
30/06/X2	Dr Contract Liability Cr Revenue	$1.2m $1.2m	Revenue	$1.2m
			BALANCE SHEET	
			Asset	
	Dr WIP (Building) Cr Cash	$1.2m $1.2m	Cash	$0.8m
			WIP (Building)	$1.2m
			Liability	
			Contract Liability	$0.8m
			Equity	
			Retained Profits	$1.2m

Financial year ended 30 June 20X3			30 June 20X3	
01/04/X3	Dr Contract Liability Cr Revenue	$0.8m $0.8m	INCOME STATEMENT	
	Dr WIP (Building) Cr Cash	$0.8m $0.8m	Revenue	$0.8m
			BALANCE SHEET	
			Asset	
	Dr Building Cr WIP (Building)	$2m $2m	Cash	$nil
			Building	$2m
			Liability	
			Contract Liability	$nil
			Equity	
			Retained Profits	$2m

Exhibit 2 As principal, recognise income from the grant (apply [draft] AASB 10XX)

Financial year ended 30 June 20X2			30 June 20X2	
01/07/X1	Dr Cash Cr Income	$2m $2m	INCOME STATEMENT	
30/06/X2	Dr WIP (Building) Cr Cash	$1.2m $1.2m	Income	$2m
			BALANCE SHEET	
			Asset	
			Cash	$0.8m
			WIP (Building)	$1.2m
			Equity	
			Retained Profits	$2m

Financial year ended 30 June 20X3			30 June 20X3	
01/04/X3	Dr WIP (Building) Cr Cash	$0.8m $0.8m	INCOME STATEMENT	
	Dr Building Cr WIP (Building)	$2m $2m	Income	$nil
			BALANCE SHEET	
			Asset	
			Cash	$nil
			Building	$2m
			Equity	
			Retained Profits	$2m

Exhibit 3 As agent, recognise revenue from the grant (apply AASB 15)

Financial year ended 30 June 20X2			30 June 20X2	
30/06/X2	Dr WIP (Building) Cr Revenue	$1.2m $1.2m	INCOME STATEMENT	
			Revenue	$1.2m
			BALANCE SHEET	
			Asset	
			WIP (Building)	$1.2m
			Equity	
			Retained Profits	$1.2m

Financial year ended 30 June 20X3			30 June 20X3	
01/04/X2	Dr WIP (Building) Cr Revenue	$0.8m $0.8m	INCOME STATEMENT	
	Dr Building Cr WIP (Building)	$2m $2m	Revenue	$0.8m
			BALANCE SHEET	
			Asset	
			Building	$2m
			Equity	
			Retained Profits	$2m

Exhibit 4 As agent, recognise income from the grant (apply [draft] AASB 10XX)

Financial year ended 30 June 20X2				30 June 20X2	
01/07/X1	Dr Right to receive WIP Cr Income	$2m $2m		INCOME STATEMENT	
30/06/X2	Dr WIP (Building) Cr Right to receive WIP	$1.2m $1.2m		Revenue	$2m
				BALANCE SHEET	
				Asset	
				WIP (Building)	$1.2m
				Right to receive WIP	$0.8m
				Equity	
				Retained Profits	$2m

Financial year ended 30 June 20X3				30 June 20X3	
01/04/X2	Dr WIP (Building) Cr Right to receive WIP	$0.8m $0.8m		INCOME STATEMENT	
	Dr Building Cr WIP (Building)	$2m $2m		Revenue	$nil
				BALANCE SHEET	
				Asset	
				Building	$2m
				Equity	
				Retained Profits	$2m