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 Addendum
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Note to the Board: This paper should be read in conjunction with paragraphs 35-41 of Agenda Paper 3.3

Introduction, objective and recommendation of this paper

1 The objective of the addendum is to help the Board to make decisions in relation to Agenda Paper 3.3 *Capital Grants*. In that paper, staff identified three key decision points for whether AASB 15 or the revenue recognition requirements of [draft] AASB 10XX apply to the capital grants.[1] The discussion of the third key decision point "do those obligations require the entity to transfer goods or services to a customer?" included two different views on whether a capital grant involves a promise to transfer to the customer goods or services:

(a) 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 – there is a

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[1] In Agenda Paper 3.3 staff identified three key decision points for whether AASB 15 or the revenue recognition requirements of [draft] AASB 10XX apply to the capital grants, they being:

(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 three decision points, the capital grant is accounted for in the scope of [draft] AASB 10XX.

transfer of goods/services to a customer, therefore, AASB 15 applies – for the NFP entity to recognise revenue under AASB 15 there must be a transfer of goods and services to a customer which is not the NFP; and

(b) 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, as the transfer of goods and services is actually to the NFP entity, therefore, the capital grant is not within the scope of AASB 15, [draft] AASB 10XX applies.[2]

Those supporting view 2 argue that an obligation to transfer one asset into another asset is not a performance obligation or another form of liability because there is no external transfer of the asset. There is no service provided by the NFP to another party, or good transferred to another party, other than the cash. The transfer of cash is not considered a good or a service.

2 The fourth question for Board members in Agenda Paper 3.3 is "Do Board members agree with the staff view that a capital grant will involve a transfer of goods/services to a customer?".[3]

(a) Part 1 of the addendum provides additional information relevant to View 1 to help members in answering that question. The staff recommend adding a paragraph to [draft] AASB 10XX *Income of Not-for-Profit Entities* to make clear that on recognising cash received with a condition that a specific asset be purchased/constructed with the funds, that there is a transfer of goods and services for the purposes of applying AASB 15 to the transaction (the transfer of the cash to the NFP entity.

(b) Part 2 of the addendum **is only relevant if the Board supports View 2 that a capital grant does not involve a transfer of goods/services to a customer**. Part 2 of the addendum provides additional information relevant to View 2 and identifies three different viewpoints on when revenue would be recognised under [draft] AASB 10XX.

<u>Part 1</u>

Staff analysis and question for the Board

3 The foundations for View 1 presented in paragraph 1 were established during a staff discussion of different ways that the grantor of a cash grant might achieve its objective (e.g., the building of an early learning facility). Staff considered the substance of the transaction to determine whether there was a transfer of goods to a customer.

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[2] The paragraphs, the question and the illustrative example are reproduced in the Appendix to this paper.

[3] Note this is a key issue that IPSASB is also currently addressing. That is, whether IFRS 15 applies to these types of transactions. This is also an issue whenever an entity receives cash with a condition being that an asset is acquired with those funds (i.e. it is not specifically restricted to assets of a 'capital' nature).

4 One way of considering this transaction is that, in substance, this is the same as the Government directly transacting with the construction company, and then transferring the WIP asset simultaneously to the Preschool. Depending on the facts and circumstances the building may be transferred progressively to the Preschool or upon completion. There may be further performance obligations to meet when the transfer occurs, depending on the facts and circumstances, which would need to be assessed under AASB 15. This approach would result in revenue being recognised progressively as the building is built where there is a progressive transfer of control and no further performance obligations, or recognition when the building is complete if control transfers on completion and there is no further performance obligations. Any further performance obligations regarding usage of the building would then need to be assessed.

5 Another approach discussed by staff, is to consider that the Preschool receives the cash grant as an agent to facilitate an arrangement between State Government (grantor) and a construction company (principal) to build the building on the preschool's land. The agent does not control the cash grant received and therefore does not recognise an asset due to the specific conditions attached to the grant. Accordingly, it can be argued the Preschool does not have control of the funds until they have been expended in the way that the condition requires.

6 The WIP is controlled by the preschool when received from the construction company (either progressively, if the construction is on the preschools own land for example, or at the end, for example, if the government controls the land). It can be considered the WIP is for services provided to the grantor (the customer). The agent's commission is the WIP and is for services provided to the grantor, that is, the preschool has facilitated an arrangement between the Government and the Construction Company to build a building on its land. The preschool recognises an asset and revenue as the building is being built. The principal (the construction company) does control the cash grant received and recognises an asset, when received from the NFP.

7 The relationship of the construction company and the State Government is that of vendor and customer. On recognising an asset, the construction company has outstanding performance obligations and therefore recognises a contract liability, with revenue recognised as it satisfies its performance obligations. Therefore, the accounting entries for the principal and the agent for the financial year ended 30 June 20X2 that follow are the outcome of applying AASB 15 (i.e., View 1). Note that the accounting entries for the grantor are also provided for completeness.

8 In this scenario, the gross amount of cash received **is not** recognised as an asset of the NFP entity with an associated performance obligation, the accounting is on a "net" basis, with revenue recognised progressively. This is similar to the simultaneous transfer outcome above.

State Government (Grantor)	**Construction Company (Principal)**	**Preschool (Agent)**
Financial year ended 30 June 20X2	Financial year ended 30 June 20X2	Financial year ended 30 June 20X2

State Government (Grantor)	Construction Company (Principal)	Preschool (Agent)
1 July 20X1 Dr Prepayment for Building $2m Cr Cash $2m	1 July 20X1 Dr Cash $1.2m Cr Contract Liability $1.2m	
30 June 20X2 Dr WIP $1.2m Cr Prepayment for Building $1.2m	30 June 20X2 Dr Construction Exp $1.2m Cr Cash $1.2m	30 June 20X2 Dr WIP $1.2m Cr Revenue $1.2m
Dr Grant expense Cr WIP*	30 June 20X2 Dr Contract Liability $1.2m Cr Revenue $1.2m	

9 An alternative view, is that the NFP considers it does control the cash, but has an obligation to build the building, otherwise the cash needs to be returned. Accordingly, the substance of the transaction is that there is a transfer of goods and services to the government and a simultaneous transfer of the resulting asset to the NFP, but that to avoid double-counting of revenue (and to reflect the substance that the government never intends to use/control the asset), the two elements of the transaction are collapsed and accounted for on a net basis.

10 The accounting entries for the financial year ended 30 June 20X2 would be[4]:

	State Government (Grantor)	Preschool (Principal)
01/07/X1	Dr Prepayment for management services $2m Cr Cash $2m	Dr Cash $2m Cr Contract Liability $2m
30/06/X2	Dr grant expense $1.2m Cr prepayment for management services $1.2m	Dr Contract Liability $1.2m Cr Revenue $1.2m

[4] Note these journals are also shown in Exhibit 1 of the Appendix to Agenda Paper 3.3

	State Government (Grantor)	Preschool (Principal)
		Dr WIP $1.2m Cr Cash $1.2m

11 Although the overall accounting outcome should be the same regardless of how the grantor achieved its objective. That is, the overall net accounting entries as an agent should provide the same outcome as the accounting entries as principal the issue is whether the accounting is on a “gross” (recognise cash and performance obligation liability on day 1) or “net” basis (recognise asset progressively).

Panel discussion

12 The Panel in their discussion with staff on this discussion point, the illustrative example, and View 1 was of the view that the construction of the early learning centre to the specifications set by the grantor is a transfer of a resource to the customer (the early learning centre). The Panel supported View 1 and noted that most capital grants would involve the transfer of resources and, as such, be within the scope of AASB 15. The Panel did not identify specific examples when this would not be outcome. This was also the feedback from targeted staff outreach.

Staff recommendation

13 Staff support 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 – there is a transfer of goods/services to a customer, therefore, AASB 15 applies.

14 For the avoidance of doubt the staff recommendation is that a paragraph be included in [draft] AASB 10XX that “On recognising an asset for a capital grant the not-for-profit entity has promised to transfer to the customer goods and/or services.”.

15 Staff also recommend further detail be added to the Basis for Conclusions to capture the Board’s decision making in relation to this issue.

Question for Board members

Q.A1 Do Board members agree with 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 – there is a transfer of goods/services to a customer, therefore, AASB 15 applies?

Q.A2 If Board members agree with Question 1, do Board members agree with the staff view to include in [draft] AASB 10XX a paragraph "On recognising an asset for a capital grant the not-for-profit entity has promised to transfer to the customer goods and/or services" and further discussion in the Basis for Conclusions?

Q.A3 Agenda Paper 3.3 includes a recommendation to include an Example in the final Standard which articulates View 1 above, with the NFP acting as a principal. Does the Board wish to include any further guidance or examples in the final Standard?

Part 2

Note that this discussion is only relevant if the Board supports View 2 that a capital grant does not involve a transfer of goods/services to a customer.

16 Part 2 of the addendum provides additional information relevant to View 2 and identifies three different views on when revenue would be recognised under [draft] AASB 10XX. The views expressed make use of the same preschool illustrative example used in Part 1 of this paper.

Staff analysis and question for the Board

View 1: [draft] AASB 10XX - Revenue is recognised on receipt of the cash (no obligation)

17 Although the preschool is required to spend that cash on constructing a building, the contract requires it to exchange one asset (cash) for another asset (a building). Therefore overall, the receipt of the grant does not impose on the preschool an obligation to transfer resources to another party (which is the essential characteristic of a liability) and, as such the revenue should be recognised on receipt of the cash. More specifically:

(a) There is no contractual obligation to transfer cash or other financial assets, i.e. no financial liability under AASB 9 – even if the preschool had entered into a contract with a building company to construct the building, that is an executory contract that doesn't give rise to a financial liability until after the construction company has performed. (e.g. see AASB 132 paragraph AG21).

(b) There is no obligation under AASB 137 – as settling an obligation created by receipt of the grant doesn't require an outflow of resources from the entity. Even if you tried to argue that there is an outflow (being the cash to be spent on constructing the building), you would then have to also recognise another asset for the building to be received in exchange for that cash – which ends up with 2 assets (cash already received and building to be received) and one liability (cash outflow for the building construction), so there is still a net amount of revenue equal to the grant received.

View 2: [draft] AASB 10XX - Revenue is recognised when the entity's "obligation" to the grantor is satisfied

18 Under View 2 revenue is recognised when the preschool's "obligation" to the State Government is satisfied – which could be:

(a) when the building has been completed, or

(b) over time, as it is being built.

This viewpoint is based on an expanded version of what constitutes a "performance obligation", whereby a liability exists if there is an enforceable obligation on the entity to "perform" by spending the money as specified.

19 IPSAS 23 could be interpreted as applying this notion, in that it discusses a "present obligation" as "a duty to act or perform in a certain way"[5] and a performance obligation as being an obligation to "use or consume the resources received for a particular purpose"[6]. It's not very clear whether using or consuming the resources received "for a particular purpose" should be read broadly (so captures situations where the funds must be spent on acquiring an asset) or more narrowly (so only where the purpose involves a transfer of goods/services to another party, so there is an outflow of resources). The discussion in IPSAS 23 paragraph 15 suggests there does need to be an overall outflow of economic resources in order for a liability to exist. Staff understand that, in practice, a broader view of what constitutes a "condition" under IPSAS 23 is taken, which could include recognising a deferred revenue liability on receipt of a grant when the grantor specifies that the funds received must be spent on buying/building an asset or returned to the grantor if not spent in the manner specified.

View 3: [draft] AASB 10XX - Revenue is recognised over the life of the building.

20 This view is that in requiring that the money is spent on constructing a building for use in the preschool's operations, in effect, the State Government is requiring the funds to be spent on providing goods/services to other parties, as the building is used over its life. This ends up with a similar result as AASB 120 (assuming the deferred revenue treatment is applied[7]). Under this view, the presence of a liability may not be

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5 IPSAS 23.51: A present obligation is a duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts.

6 IPSAS 23.15: Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached.

7 AASB 120.26: One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

consistent with the facts, that is, the restriction on the use of the building is not a liability.

Panel input

21 The Panel in their discussion with staff supported View 1 and therefore did not discuss View 2 or any of the views described in Part 2 of this paper.

Question for Board members

Q.A4 If Board members do not agree with Question 1, would Board members like to include one of the views in [draft] AASB 10XX? If so, which view?