

INCOME OF NOT-FOR-PROFIT ENTITIES: DRAFT EXPOSURE DRAFT

DRAFT BASIS FOR CONCLUSIONS

This Basis for Conclusions accompanies, but is not part of, AASB ED XX.

Note to Board members: This draft Basis for Conclusions includes material that may ultimately be set out in Application Guidance for the ED. That material is included to assist understanding of the bases for the conclusions.

Introduction

- BC1 This Exposure Draft (ED) proposes requirements for recognition, measurement, presentation and disclosure of income by Australian not-for-profit entities (NFPs) in the public and private sectors. It is the result of the Australian Accounting Standards Board's (AASB's) redeliberation of the proposals in AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* in the light of comments received on that ED.
- BC2 AASB ED 180/FRSB ED 118 was developed jointly by the AASB and the New Zealand Financial Reporting Standards Board (FRSB) and issued for comment in June 2009. The Board's objective was for that proposed Standard to replace AASB 1004 *Contributions*. AASB ED 180/FRSB ED 118 was closely based on International Public Sector Accounting Standard IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. After reviewing the comments received on AASB ED 180/FRSB ED 118, the Board decided not to proceed with those proposals and instead to propose different requirements, based on IASB ED/2010/6 *Revenue from Contracts with Customers*, as updated for tentative decisions made by the IASB in its redeliberations of that ED's proposals.
- BC3 This Basis for Conclusions summarises the AASB's considerations in reaching its conclusions on this ED. It sets out the reasons why the Board developed the ED, the approach taken to developing the ED and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for Developing the Exposure Draft

BC4 AASB ED 180/FRSB ED 118 included proposals for the recognition, measurement, presentation and disclosure of income in relation to ‘non-exchange transactions’, which include transfers (such as grants, donations and bequests) and taxes. Such transactions often dominate the income streams of NFPs. AASB 1004 *Contributions* applies only to NFPs and addresses income from non-exchange transactions. However, there is a range of views in Australia concerning whether the requirements in AASB 1004 are appropriate, particularly in relation to transfers intended to be utilised over a specified period and transfers subject to conditions. AASB ED 180/FRSB ED 118 included proposals that responded to those concerns.

BC5 Unlike the requirements in AASB 1004, the proposals in AASB ED 180/FRSB ED 118 would have required liabilities to be recognised in relation to non-exchange transactions when transferred assets are received on the stipulation that the recipient entity must either:

- (a) consume the future economic benefits embodied in the transferred assets as specified (that is, honour a performance obligation); or
- (b) return the future economic benefits to the transferor (that is, honour a return obligation).

BC6 This ED is the result of the AASB’s redeliberations of the proposals in AASB ED 180/FRSB ED 118. Key aspects of those redeliberations are noted in paragraphs BC7 – BC11.

Redeliberations of Proposals in AASB ED 180/FRSB ED 118

Comments on AASB ED 180/FRSB ED 118

BC7 The AASB and FRSB received 31 comment letters on AASB ED 180/FRSB ED 118 from Australian and New Zealand respondents. Respondents were fairly evenly divided on whether they supported the ED’s proposals. However, a significant number of respondents expressed concern that:

- (a) the ED's definition of a 'non-exchange transaction' (namely, a transaction in which "an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange") is ambiguous and difficult to apply in practice; and
- (b) the ED's proposal that a liability arises from a non-exchange transaction only when a performance obligation is accompanied by a return obligation adopts too narrow a notion of a liability. Numerous respondents argued that an entity's performance obligations are liabilities regardless of whether they are accompanied by other obligations.

BC8 In view of these concerns, as noted in paragraph BC2, the Board decided not to proceed with the proposals in the ED. Paragraphs BC9 – BC11 discuss the Board's consideration of other approaches, in the process of developing the proposals in this ED.

AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*

BC9 The Board considered again whether to propose extending the scope of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*, which incorporates IAS 20 (of the same title). AASB 120 applies only to for-profit entities. The Board noted that such an extension would result in government grants being accounted for under a strictly transaction-neutral approach. However, the Board reaffirmed its previous decision not to propose extending the scope of AASB 120, for a number of reasons:

- (a) AASB 120 addresses only government grants and government assistance, and therefore does not address many other forms of transfers and also taxes. Furthermore, transfers and taxes are more likely to have a material impact on the financial statements of NFPs than on the financial statements of for-profit entities;
- (b) application of the recognition and presentation requirements in that Standard could result in entities' assets and net assets being materially understated. For example:

- (i) government grants of non-monetary assets may be measured at a nominal amount;
 - (ii) government grants relating to assets may be deducted in determining the carrying amount of the assets; and
 - (iii) grants are not to be recognised by an entity until there is reasonable assurance that the entity will comply with the conditions attaching to the grants and the grants will be received;
- (c) AASB 120 focuses on recognition of deferred income, without specifying the nature of obligations to be recognised as liabilities. Thus, it does not distinguish performance obligations and return obligations, and therefore does not clarify when the stipulations attaching to a grant should be considered to have been met; and
- (d) the International Accounting Standards Board (IASB) had indicated an intention to review IAS 20 in line with more current approaches to recognition and presentation matters.

IASB ED/2010/6 *Revenue from Contracts with Customers*

BC10 The Board decided that performance obligations (obligations to provide goods or services) are liabilities. Therefore, it considered applying the IASB's proposed guidance on performance obligations to the identification of liabilities arising from the receipt, by NFPs, of assets in non-exchange transactions. Proposed IASB guidance on the meaning of a 'performance obligation' is included in IASB ED/2010/6 *Revenue from Contracts with Customers*.

BC11 The Board decided that the principles in the IASB's proposed guidance on performance obligations can be applied to any entity, whether for-profit or NFP, in the private sector or public sector. It decided to update the proposals in IASB ED/2010/6 in accordance with tentative decisions made by the IASB in its redeliberations of that ED's proposals, and to modify that updated IASB guidance to the extent necessary to express the principles in a manner that can be applied by NFPs.

BC12 Key features of the IASB guidance and proposed NFP modifications are discussed in paragraphs BC17 – BC51.

Scope

Not-for-profit entities

BC13 The scope of this ED is limited to NFPs (whether in the private sector or the public sector). The Board noted that, in the absence of a Standard applying to for-profit entities that specifically deals with the types of transactions within the scope of this ED, a for-profit entity should develop an accounting policy in the same way that it would for any issue – in accordance with the requirements on the selection of accounting policies set out in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. For-profit entities would also have to apply the requirements of any other relevant Standard (for example, AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*). The Board concluded that it would be inappropriate for this ED to provide any guidance on the selection of accounting policies by for-profit entities, given the Board's policy of ensuring that for-profit entities can make an unreserved statement of compliance with IFRSs.

Income

BC14 Although the proposed principles in this ED are based on those in IASB ED/2010/6 and the IASB's subsequent redeliberations, the scope of this ED includes income—rather than revenue—of NFPs. This is because:

- (a) the definition of revenue in AASB 118 *Revenue* is limited to particular inflows of economic benefits arising in the course of the entity's ordinary activities;
- (b) the Board noted that many significant types of income of NFPs (such as some types of taxes and transfers, which presently fall within the scope of AASB 1004), can arise from transactions outside the course of the entity's ordinary activities. Limiting the scope of this ED to revenue of NFPs would therefore omit to provide guidance for significant types of

income of NFPs and only partially meet the Board's objective to replace AASB 1004; and

- (c) the Board concluded that this ED's proposed principles are appropriate for revenue and other income of NFPs.

BC15 Incorporating all income of NFPs in the scope of this proposed Standard is consistent with the Board's previous decision not to limit the scope of AASB ED 180/FRSB ED 118 to revenue from non-exchange transactions.

Exchange and non-exchange transactions

BC16 The Board decided that the accounting for transactions involving income of NFPs should be determined by considering which financial statement elements arise, without being concerned with whether the transactions are 'exchange', 'non-exchange' or a combination of both. The Board is of the view that the existence of, for example, a transferred asset or a performance obligation does not depend on whether it arose from an 'exchange' or 'non-exchange' transaction. Accordingly, this ED applies to income recognition by NFPs and its scope is not limited to income from non-exchange transactions. A consequential benefit of this approach is that it avoids the difficulties encountered by various constituents in consistently distinguishing exchange and non-exchange transactions.

Proposals Based on IASB ED/2010/6

BC17 The Board decided to propose applying the key proposals of IASB ED/2010/6, updated for tentative decisions made by the IASB in its redeliberations of that ED's proposals in the light of comment letters on that ED.¹ Those updated key proposals are that:

Note to Board members: Some of the information below about the IASB's updated proposals might later be omitted from the Basis for Conclusions, but is included in this draft for Board members' convenience. Please note these proposals do not cover presentation and disclosure, which will be addressed in future Board papers.

¹ This draft incorporates tentative decisions by the IASB up to (and including) 18 May 2011.

- (a) the IFRS's scope is limited to contracts with customers:
- (i) it defines a 'contract' as "an agreement between two or more parties that creates enforceable rights and obligations";
 - (ii) it defines a 'customer' as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities"; and
 - (iii) it states that "Contracts with customers oblige an entity to provide goods or services in exchange for consideration"; [*see discussion of proposed NFP modifications in paragraphs BC19 – BC25*]
- (b) contracts should be combined and accounted for as a single contract when they are entered into at or near the same time with the same customer (or related entities), if at least one of the following criteria is met:
- (i) the contracts are negotiated as a package with a single commercial objective;
 - (ii) the amount of consideration in one contract depends on the other contract; and
 - (iii) the goods and services in the contracts are inter-related in terms of design, technology or function;
- (c) revenue is recognised when the entity satisfies a performance obligation by transferring promised goods or services to the customer. A 'performance obligation' is defined as "an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer"; [*see discussion of proposed NFP modifications in paragraphs BC26 – BC33*]
- (d) performance obligations are identified from the terms of the contract and the entity's customary business practice;
- (e) an entity should account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating

those goods or services into a single item that the entity provides to the customer. This would be the case if the goods or services are highly inter-related and providing them requires the entity to provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted. The service typically results in significant modification of the goods in the contract;

- (f) when the circumstances in (e) do not apply, a promised good or service is accounted for as a separate performance obligation if:
 - (i) the pattern of transfer of the good or service is different from the pattern of transfer of other promised goods or services in the contract; and
 - (ii) the good or service has a distinct function. This occurs when either:
 - A the entity regularly sells the good or service separately; or
 - B the customer can use the good or service either on its own or together with resources that are readily available to the customer; [*see discussion of NFP issue in paragraph BC25*]
- (g) the transaction price should be allocated to each performance obligation. In this regard, the 'transaction price' for a contract is the amount of consideration to which the entity expects to become entitled from the customer in exchange for transferring goods or services. That amount should be estimated as either of the following amounts, depending on which is the most predictive of the amount of consideration to which the entity will become entitled:
 - (i) the probability-weighted estimate of the consideration (including variable consideration); and
 - (ii) the most likely amount of consideration;
- (h) the transaction price determined in accordance with (g) should be allocated to each performance obligation on the basis of the relative

stand-alone selling price of each performance obligation in the contract. Where the stand-alone selling price of a good or service underlying a separate performance obligation is highly variable, the most appropriate technique to estimate a stand-alone selling price may be a residual technique. Using a residual technique, an entity would determine a stand-alone selling price by reference to the total transaction price less the stand-alone selling prices of other goods or services in the contract; [see discussion of proposed NFP modifications in paragraphs BC34 and BC38 – BC40]

- (i) if an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity should recognise a refund liability and measure it at the probability-weighted amount of consideration that the entity expects to refund to the customer (that is, the difference between the amount of consideration received and the transaction price); [see discussion of proposed NFP modifications in paragraphs BC43 – BC45]
- (j) any expected impairment loss on amounts receivable from customers should be recognised separately from the amount receivable, with the related loss presented as a separate line item adjacent to revenue (as contra revenue);
- (k) as each performance obligation is satisfied by providing goods or services, revenue should be recognised at the amount allocated to the satisfied performance obligation, unless the entity is not reasonably assured to be entitled to that amount;
- (l) revenue should be recognised, in accordance with (c) and (k), by determining whether goods or services are provided to the customer;
- (m) a service is provided when the performance obligation is satisfied continuously. This occurs when at least one of the following two criteria is met:
 - (i) the entity's performance creates or enhances an asset that the customer controls as the asset is being enhanced or created; or

- (ii) the entity's performance does not create an asset with an alternative use to the entity, and at least one of the following conditions is met:
 - A the customer receives a benefit as the entity performs each task;
 - B another entity would not need to reperform the task(s) performed to date if that other entity were to fulfil the remaining obligation to the customer; and
 - C the entity has a right to payment for performance to date even if the customer could cancel the contract for convenience;
- (n) revenue should be recognised, in accordance with (c) and (k) – (m):
 - (i) in relation to promised goods, when control of those goods transfers to the customer; and
 - (ii) in relation to promised services, as the entity makes progress toward successful completion of the service;
- (o) a liability and corresponding expense should be recognised if all three of the following criteria are met:
 - (i) a contract is onerous. This is the case when the transaction price for that contract is exceeded by the lower of:
 - A the present value of the probability-weighted costs that relate directly to satisfying the performance obligations in that contract; and
 - B any amounts the entity would have to pay to cancel the contract;
 - (ii) the performance obligations arise from a long-term contract; and

- (iii) a loss remains to be recognised after recognising any impairment loss on assets related to the contract; [*see discussion of proposed NFP modifications in paragraphs BC46 – BC51*] and
- (p) a contract is not excluded from being accounted for as onerous if it is intentionally priced at a loss in the expectation of generating profits on subsequent contracts with the customer (a ‘loss-leader’ contract).

BC18 Proposed NFP modifications to the [expected] IFRS on *Revenue from Contracts with Customers* are discussed in paragraphs BC19 – BC51.

Proposed NFP Modifications to the IFRS

Terminology

BC19 Often, NFPs receive assets through grants and other transfers, where those transactions:

- (a) are not described in everyday language as involving contracts, even though the transactions may involve detailed stipulations;
- (b) are not widely regarded as transactions with ‘customers’; and
- (c) require the NFP to provide goods or services to beneficiaries that are not a party to the arrangement. In these circumstances, views may differ regarding which party or parties should be regarded as the ‘customer(s)’.

BC20 The Board considers that these aspects do not warrant departing from the proposed treatment in IASB ED/2010/6, and instead warrant clarification of the terminology in that ED. The Board’s reasons for that conclusion and its proposed clarifications are discussed below.

Contracts

BC21 The Board observes that the definition of a ‘contract’ in the IASB ED is very broad, and simply requires an agreement creating enforceable rights and obligations for the parties involved. In addition, the IASB ED says contracts can be written, oral or implied by the entity’s customary business practice.

This definition and guidance should readily be able to be applied by NFPs, with the minor clarifications to:

- (a) replace 'agreement' with 'arrangement' in the definition of a contract, to cover transactions not involving the agreement of the NFP recipient (for example, assets might be transferred to a government department with a directive that they be deployed to provide specified services); and
- (b) omit 'business' from the above-mentioned guidance on the nature of contracts.

Customers

BC22 In response to concerns that many transactions for the provision of goods or services entered into by NFPs are not regarded as transactions with 'customers', the Board observed that the notion of a customer in particular is not essential when applying the IASB's revenue recognition model in a broader setting. This is because:

- (a) the term 'customer' could be replaced with a more sector-neutral phrase like 'other party to the transaction' without changing the meaning; and
- (b) the only restriction that the IASB's proposed definition of 'customer' makes on a party that contracts (or arranges) with the entity to obtain goods or services is to limit those goods or services to an output of the entity's ordinary activities. This limitation is inappropriate in an ED that is not limited to revenue.

BC23 Instead of focusing on the existence of customers, the Board proposes focusing on whether performance obligations to external parties exist. The identity of those external parties is not important to the adaptation of the IASB's revenue recognition model in a NFP context.

BC24 Similarly, the fact that various transactions require a NFP to provide goods or services to beneficiaries that are not a party to the arrangement does not undermine the application of the principles of the IASB's model by NFPs. That IASB model is centred on the satisfaction of performance obligations by providing goods or services to other parties to whom those goods or services

are promised. Therefore, it should be irrelevant whether the promised goods or services are provided to the original transferor or to other beneficiaries.

BC25 A criterion in identifying separate performance obligations under the IASB's proposals is whether the customer can use the good or service either on its own or together with resources that are readily available to the customer (see paragraph BC17(f)(ii)B). Applying the substance of this notion requires that the entity has a general awareness of the circumstances of the recipients of goods or services it provides. The Board is not aware of reasons why this information should be more difficult for NFPs to obtain than for-profit entities. In many cases NFPs provide services to beneficiaries that are consumed immediately by them and appear to clearly meet that criterion.

Performance Obligations

BC26 The Board proposes that a promise to provide goods or services is a performance obligation if it has the following features, which are inter-dependent:

- (a) it involves a sufficiently specific stipulation regarding the entity's promised performance; and
- (b) it is enforceable.

Sufficiently specific stipulation

BC27 Requiring a performance obligation to involve a sufficiently specific stipulation regarding the entity's promised performance enables reasonably objective identification of when a performance obligation has been satisfied. The Board decided to add the NFP-specific guidance in paragraphs BC28 – BC29 on what constitutes a sufficiently specific stipulation, because NFPs often enter into arrangements in which the nature and extent of obligations to provide goods or services are less clearly specified than contractual promises made by for-profit entities.

BC28 A promise to provide goods or services involves a sufficiently specific stipulation if it is specified as to:

- (a) the nature or type of goods or services to be provided; and
- (b) one or more of:
 - (i) the cost or value of the goods or services;
 - (ii) the volume of the goods or services; and
 - (iii) the period over which the goods or services must be provided.

BC29 In relation to paragraph BC28(b)(iii), the Board concluded that a stipulation that a transfer of assets to a NFP relates to a particular time period is, of itself, insufficient to meet this criterion. This is because time does not require an outflow of resources embodying economic benefits (the definition of a liability in the AASB *Framework for the Preparation and Presentation of Financial Statements* requires such an outflow in settlement of the obligation). Rather, such a stipulation is, in substance, an indication that the transferor will not make similar future transfers to the entity for a defined period of time.

Note to Board members: The Board previously noted a number of issues would arise regarding the above meaning of a sufficiently specific stipulation, and decided to monitor this issue as work on developing a ‘performance obligations approach’ proceeds. For example, the Board observed that transferor stipulations regarding the nature or type of goods or services to be provided can vary in detail. Mitigating this, the Board observed that, for a stipulation to be enforceable, it would need to be reasonably specific regarding the nature or type of goods or services to be provided.

Enforceability

BC30 The Board decided to add NFP-specific guidance that an obligation to provide goods or services must be enforceable, and the guidance in paragraphs BC31 – BC33 on the circumstances in which this may occur. This is because a wider range of potential mechanisms may be employed to enforce a NFP’s promises to provide goods or services than similar promises by for-profit entities. For example, transferors may not need to resort to court action to enforce promises that a NFP transferee fails to honour.

Note to Board members: The IASB recently decided to remove its reference to obligations being ‘enforceable’, but the purpose of this change is understood to be to avoid misunderstandings that a performance obligation must be legally enforceable. For the purpose of current drafting of this Basis for Conclusions, the reference to enforceability has been retained.

BC31 This ED proposes that, for a promise to provide goods or services to be regarded as ‘enforceable’, the transferor must be capable of enforcing that promise by legal or equivalent means. In this regard:

- (a) a right to enforce specific performance would ensure that the promise is enforceable;
- (b) a directive given by a Minister or government department to a public sector entity to provide specified goods or services gives rise to a promise that is enforceable by legal or equivalent means;
- (c) if either a return obligation or a capacity to impose a severe penalty for non-performance accompanies a promise to provide goods or services, it indicates the performance obligation is enforceable. In some environments, where rights of specific performance are unavailable or unnecessary, a return obligation or a capacity to impose a severe penalty may be the key indicator of the enforceability of a promise to provide goods or services;
- (d) a transferor’s capacity or threat to withhold future funding from a transferee if stipulated goods or services are not provided would not of itself give rise to enforceability of the promise to provide those goods or services; and
- (e) a NFP’s statement of intent to spend money or consume resources in particular ways may subsequently be the subject of budget-to-actual reporting to discharge accountability for the raising and expenditure or consumption of resources. However, that statement of intent and related accountability mechanisms do not of themselves make a promise to provide goods or services enforceable by legal or equivalent means.

Enforceability of a promise requires the existence of other parties with the power to enforce the promise by legal or equivalent means.

BC32 If a transferor withholds contractually-promised future funding from a transferee because stipulated goods or services were not provided, that action would constitute the cancellation of a receivable, and thus is indistinct from the return of a transferred asset referred to in paragraph BC31(c). In relation to paragraph BC31(d), a conditional capacity to cancel an amount presently receivable by the transferee is different from a threat or capacity not to undertake an expected future transaction.

BC33 Taxes would never be identified as giving rise to performance obligations,² even when they are raised in respect of specific goods or services. This is because promises to provide goods or services would not be enforceable against the tax recipient by legal or equivalent means.

Measurement

BC34 The Board proposes that the IASB's proposed measurement requirements for liabilities to customers should be conformed to by NFPs in accounting for liabilities to transferors and other parties to which it provides goods or services. The exception to this is in relation to how the transaction price for an arrangement is allocated to the separate performance obligations. The Board's proposed modification of the allocation basis decided by the IASB, and its reason for that modification, are discussed in paragraphs BC38 – BC40.

BC35 The Board also proposes one modification of the measurement requirements in AASB 9 *Financial Instruments*, and to add guidance clarifying how 'advance receipts' should be measured under AASB 9. This is discussed in paragraphs BC41 – BC45.

BC36 Before focusing on this ED's proposed modifications of the measurement requirements in IFRSs, this Basis notes the views of the Board regarding application of the measurement requirements in IFRSs. The Board proposes

² However, if tax payments are received on the condition that they be returned if an uncertain future event occurs, or fails to occur, they would give rise to a refund obligation that should be recognised as a liability. The treatment of refund obligations is discussed in paragraphs BC43 – BC45.

that financial assets, financial liabilities and non-financial assets of NFPs arising from transactions within the scope of this ED should initially be measured in accordance with the measurement requirements of the Standard applying to that class of assets or liabilities (for example, AASB 9 or AASB 116 *Property, Plant and Equipment*). This decision reflects the Board's conclusion that there is not a NFP-specific reason to depart from these requirements.

BC37 IASB ED/2010/6 proposes that, to determine the transaction price in a contract with a customer, non-cash consideration (or a promise of non-cash consideration) is measured at fair value. Accordingly, the Board concluded that, in contrast with some Australian Accounting Standards with NFP-specific guidance, this ED does not need an 'Aus' paragraph dealing with the initial measurement of 'cost' (at fair value) when an asset is acquired for no cost or for a nominal cost.

Non-financial liabilities: modification of the measurement requirements proposed in IASB ED/2010/6

BC38 The Board proposes that non-financial liabilities (such as performance obligations) of NFPs arising from transactions within the scope of this ED should be measured consistently with the principles underpinning IASB ED/2010/6, but those principles should be re-expressed in a manner leading to recognition of income from transactions or components of transactions that do not give rise to liabilities. The Board considers that re-expression of those principles is necessary because the specific requirements proposed in IASB ED/2010/6 do not acknowledge transactions involving a donation (or other contributory) element. The Board noted that, in some transactions of NFPs, the contributory element may be the main component of the transaction. Accordingly, the Board specifically proposes that :

- (a) non-financial liabilities of NFPs should be measured directly at the stand-alone selling price of the unit of account for the usual sale of the goods or services that are the subject of the obligations. This would apply if sufficient evidence of the stand-alone selling price for that unit can be estimated reliably;

- (b) in relation to (a), this ED does not identify for NFPs a single best method of those identified in IASB ED/2010/6 for estimating the stand-alone selling price of a good or service that is the subject of a performance obligation. This is because the best method will depend on the evidence available in the circumstances, and professional judgement will be necessary in applying the principles in the Standard;
- (c) any multiple obligations composing the unit of account in (a) should be measured indirectly on a relative stand-alone selling price basis (for example, allocating any discount to each obligation within that unit); and
- (d) the difference between the total transaction price and the sum of the stand-alone selling prices of each unit of account, determined in accordance with (a) – (c) above, should be recognised as income or expense immediately. Thus, the relative stand-alone selling price allocation proposed in IASB ED/2010/6 should be limited to each unit of account for the obligations, and should not nullify the recognition of income for any contributory element of the transaction.

BC39 The Board also proposes that, when there is insufficient evidence to estimate reliably the stand-alone selling price for the unit of account for the usual sale of goods or services in an arrangement, the related obligations should be measured directly as provisions under the requirements of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. The difference between the total transaction price and the sum of the performance obligations measured on this basis should be recognised as income or expense immediately.

BC40 As mentioned in paragraph BC17(h), under the proposals in IASB ED/2010/6, as subsequently amended, where the stand-alone selling price of a good or service underlying a separate performance obligation is highly variable, the most appropriate technique to estimate a stand-alone selling price may be a residual technique. Using a residual technique, an entity would determine a stand-alone selling price by reference to the total transaction price less the stand-alone selling prices of other goods or services in the contract. The proposed residual approaches described in paragraphs BC38 and BC39 are akin to the IASB's residual approach for items with highly variable stand-alone

selling prices. The difference is that, under the IASB's approach for these items, the transaction price for the contract would still be fully allocated to all of the performance obligations. In contrast, under paragraphs BC38 and BC39, the residual would be recognised as income or expense immediately. This difference is recognised to faithfully reflect that for NFPs, various transactions involve a donation (or other contributory) element.

Note to Board members: Paragraph BC38 reflects tentative decisions made by the Board in February 2011. Staff added paragraph BC39 to cater for circumstances in which the treatment decided by the Board cannot be applied. Board members are asked to consider whether they agree with that variation.

Staff also added paragraph BC40 in response to the IASB's recent tentative decision to apply a residual technique in some circumstances to measure the stand-alone selling price of particular performance obligations, and to contrast that technique with the direct measurement approach for NFPs discussed in paragraphs BC38 and BC39. Board members are asked to consider whether they agree with that explanation.

Financial liabilities: modification and clarification of the measurement requirements in AASB 9 Financial Instruments

BC41 The Board concluded that financial assets and financial liabilities arising from transactions within the scope of this ED should be measured in accordance with the requirements of AASB 9, with initial measurement at fair value plus any transaction costs. The Board did not identify any reason to depart from the existing general requirements for measuring financial assets and financial liabilities.

BC42 The Board proposes a limited exception to paragraph B5.4.8 of AASB 9, to remove the restriction that 'day one' gains/losses on initial recognition of financial assets and financial liabilities arising from differences between the transaction amount and fair value may only be recognised when all of the variables that are inputs to the fair value estimate are observable. The Board proposes this exception because:

- (a) 'day one' gains reflecting a contributory element of a transaction are a common occurrence for NFPs; and
- (b) applying the AASB 9 'observable variables' constraint on recognising 'day one' gains/losses would give rise to a significant risk that financial statements would not recognise that contributory element, and the Board considers that recognition of such a contributory element is necessary for faithful representation of the transaction.

BC43 The Board proposes refund obligations that are not advance receipts (see discussion of advance receipts in paragraphs BC44 – BC45) should be measured consistently with the proposed measurement basis for 'refund liabilities' in IASB ED/2010/6, namely, the probability-weighted amount of consideration that the entity expects to refund. The Board supports using this measurement approach because it considers that:

- (a) this measurement approach would provide useful information about future sacrifices of economic benefits arising from those refund obligations;
- (b) if refund liabilities accompanied by performance obligations were instead measured at the amount contingently refundable (that is, without taking probability into account), recognising the performance obligation as well as the refund obligation would seem likely to cause recognition of a loss upon initial recognition of each such transaction. This would not seem representationally faithful; and
- (c) there is not a NFP-specific reason to depart from the measurement basis proposed in IASB ED/2010/6.

BC44 AASB ED 180/FRSB ED 118 discussed the recognition of liabilities for 'advance receipts', which arise mainly for NFPs rather than for-profit entities. It said: "In this Standard 'advance receipt' refers to resources received prior to a taxable event or a transfer arrangement becoming binding." In its redeliberations of AASB ED 180/FRSB ED 118, the Board reaffirmed that 'advance receipts' give rise to liabilities, if a future outflow of resources embodying economic benefits is required if the specified future event (the

taxable event occurring or the arrangement becoming binding) does not occur. The Board decided that the nature of such a liability is an unconditional obligation to stand ready to return transferred assets if the specified future event does not occur.

BC45 The Board proposes adding NFP-specific guidance that liabilities in the form of ‘advance receipts’ of taxes and transfers should, consistent with AASB 9, be measured at the amount that would be required to be returned if the taxable event did not occur or the transfer arrangement did not become binding. This would generally be the amount of the assets received in advance.

Onerous Contracts

BC46 As noted in paragraph BC17(o), the IASB proposes requiring recognition of a liability and an expense for an ‘onerous’ long-term contract when the transaction price for that contract is exceeded by the lower of:

- (a) the present value of the probability-weighted costs that relate directly to satisfying the performance obligations in that contract; and
- (b) any amounts the entity would have to pay to cancel the contract.

BC47 The Board considered concerns that, in applying that requirement, NFPs might customarily recognise onerous contract losses upon recognising transfers accompanied by enforceable obligations to provide services that will cost more to fulfil than the amount of the transfer (for example, where the transfer partially funds the entity to perform a service it already intended to perform).

BC48 The Board concluded that, in relation to this issue, the first aspect to consider is that the contract or other arrangement cannot be onerous if the entity does not have an unconditional obligation to provide services additional to those funded by the transferor. The second aspect to consider is the amount of economic benefits the entity would be required to pay if it were unable to perform services to the extent specified. As mentioned in paragraph BC46, under the IASB’s proposals, a liability for an onerous contract cannot exceed any excess of the cancellation price over the transaction price.

BC49 Furthermore, the Board concluded that contracts (or other arrangements) for the sale of services subsidised by the above-mentioned transfer should be combined with the contract/arrangement with the transferor in order to calculate the transaction price. For example, if a transfer is a subsidy for the cost of health or transport services that will also be recovered through user charges, the subsidy and estimated user charges should be summed in order to determine the transaction price. This view is largely consistent, in substance, with the IASB's proposed criteria for combining contracts that: the contracts are negotiated as a package with a single objective; the contract amounts are interdependent; and the services have the same function. The Board considers that combining the contracts/other arrangements in these circumstances would faithfully reflect the economic substance of those contracts/arrangements.

BC50 However, this treatment would not conform to the IASB's proposal that, for contracts to be combined, they must be entered into at or near the same time with the same customer or related entities. The Board proposes removing these IASB criteria from the NFP guidance on combining contracts or other arrangements, because the substance of integrally related promises—and funding thereof—in the NFP sector does not necessarily involve those features.

BC51 Finally, the Board proposes that if, after combining contracts/other arrangements in the circumstances described in paragraph BC49, the contract/other arrangement is onerous on the basis of the measurements referred to in paragraph BC46, it would be appropriate to recognise a liability and an expense after recognising any related impairment losses.

<p>Note to Board members: The Board discussed this 'onerous contracts' issue at its February 2011 meeting without making a decision. Board members are asked to consider whether they agree with this proposed treatment (including the proposed modification of the IASB's criteria for combining contracts).</p>
