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Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
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Our ref Submission - ITC 50

Contact Heng, Kim (+61 2 9455 9120)

31 March 2023

Dear Dr Kendall

Invitation to Comment - ITC 50 Post-implementation Review - Income of Not-for-Profit Entities

KPMG Australia (KPMG) is pleased to have the opportunity to respond to *Invitation to Comment - ITC 50 Post-implementation Review – Income of Not-for-Profit Entities* (ITC). In general, we have found that AASB 1058 *Income of Not-for-Profit Entities* and the guidance attached to AASB 15 *Revenue from Contracts with Customers* have been applied without extensive divergence in practice. Nevertheless, we routinely encounter two key challenges in their application.

Firstly, in determining whether a promise in a contract is sufficiently specific to be a performance obligation. In some instances, the judgements in this area have resulted in financial reporting outcomes that we observe as inconsistent with the substance of an arrangement.

Secondly, from the application of whether a not-for-profit (NFP) entity should recognise a financial liability as a related amount. Applying the requirements of AASB 1058 could in certain circumstances result in net presentation or the “collapse” of the income statement. This might be viewed as an unintended consequence of applying the standard given the charitable purpose of some impacted entities, often receiving donations or grants for forwarding to other organisations.

We have set out our detailed comments to select questions in the Appendix to this letter. Where we have no response to specific questions they have not been reproduced in the Appendix.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact Julie Locke on (02) 6248 1190, or myself on (02) 9455 9120.

Yours sincerely

Kim Heng
Partner
KPMG Australia

Appendix

Topic 1: Sufficiently specific criterion and the legal interpretation of agreements

Regarding the term sufficiently specific in AASB 15 Appendix F, do you have any comments about:

1. the application of the term in practice?
2. the extent of specificity needed to meet the sufficiently specific criterion for a contract (or part of a contract) to be within the scope of AASB 15?
3. whether differences in application exist?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

We are aware of diverging views in practice concerning whether a promise is sufficiently specific. However, we acknowledge that applying this criterion involves significant judgement and may be influenced by legal interpretations.

In our experience, there is divergence in accounting for some arrangements entered into for the dual purpose of transferring goods and services as well as to help the entity achieve its objectives. This arises from the rebuttable presumption that the transaction price is wholly related to the transfer of goods and service. The presumption may only be rebutted when the transaction price is partially refundable. We have observed arrangements where the transaction price is fully refundable but the intention of the donor was clear that part of the funds provided were for general use by the entity to achieve its objectives. A similar situation would also arise where no refund obligation exists but funds are provided within a dual-purpose arrangement. Therefore, the financial reporting outcomes associated with arrangements of similar intent are diverging based on legal refundability.

We recommend the instances in which entities may rebut the presumption the transaction price is wholly related to the transfer of goods or services be expanded such that it is clearer it may be appropriate to allocate the transaction price between the dual purpose even when all or none of the transaction price is refundable. In our view, refundability is a useful consideration but is not the sole guide to a donor's intent. For example, an arrangement might specify a range of conditions that the entity must abide by when using the funding. These conditions could be assessed as resulting in one or more sufficiently specific performance obligations but ultimately are insignificant in the context of the broader arrangement. In such a case, an entity might determine that it is appropriate to rebut the presumption and allocate the transaction price between the transfer of goods and services and donation element rather than treating all the transaction price as relating to the insignificant transfer of goods and services, accounted for in its entirety under AASB 15 or vice versa, accounted for in its entirety under AASB 1058.

4.	In addition to the existing guidance in AASB 15 Appendix F, is there any other guidance that would help you determine whether a contract (or part of a contract) is sufficiently specific? If so, please provide details of the guidance and explain why you think it would be useful.

Appendix F notes that judgement is required to consider the conditions, both explicit and implicit, in assessing whether a promise qualifies as a sufficiently specific performance obligation. Such conditions include:

(a) the nature or type of the goods or services;

(b) the cost or value of the goods or services;

(c) the quantity of the goods or services; and

(d) the period over which the goods or services must be transferred.

Whilst these conditions are useful, they are high level and significant judgement is required to apply these conditions such that diversity in practice has resulted. To illustrate the issue, the ITC on page 9 provides examples (a) to (h) of arrangements to provide counselling services and notes that obligations (f) to (h) are sufficiently specific whereas we would tend to see (f) as being maybe sufficiently specific and concluded that (g) and (h) are sufficiently specific. To be helpful, we suggest the AASB provides additional illustrative examples similar to the counselling services examples whereby the facts are modified slightly in each subsequent example and explain whether and why each example is or is not considered sufficiently specific.

Further, the illustrative examples accompanying AASB 15 make extensive use of research grants to assist in applying the above criteria to an arrangement that contains a single promise. Those examples are marginally useful outside their fact patterns and of limited utility to arrangements that contain multiple promises.

We suggest the AASB develop additional examples that illustrate the application of the NFP entity guidance to arrangements that contain multiple promises. We further suggest that those examples are not focused on research grants, but cover arrangements such as:

- arranging and hosting an event with a substantial lead-time;
- custody and care arrangements for items of historic or cultural significance (such as artworks, documents and collectibles); and
- community care and engagement.

Any additional examples should illustrate the identification of multiple performance obligations from a large set of promises where the grant is entirely refundable in the event any of the promises are not met and adopt a similar approach example to the counselling services illustrative example by modifying the facts in each subsequent example as noted above.

Topic 3: Differences between management accounts and statutory accounts and alternative revenue recognition models

9.	Do you have any comments regarding the timing of revenue recognition required by AASB 15 and AASB 1058 of NFP entities? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also helpful.
10.	Do you have any views on alternative approaches to recognising revenue in the NFP sector? For example, should an NFP entity initially recognise a liability and recognise revenue: (a) based on a common understanding between the entity and the transfer provider of the manner in which the entity is expected to us the inflows of resources; (b) where there are terms in law or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity; (c) on a systematic basis over the periods in which the entity recognises as expenses the related costs for which a grant is intended to compensate; or (d) where the outflows of resources incurred in accordance with the requirements set out in a binding agreement. If so, please provide your views on your preferred alternative(s) above or another alternative approach.

We have no specific responses to questions 9 and 10. However, in general we consider the current guidance in Appendix F to AASB 15 appropriately follows the AASB's principle of transaction neutrality as described in the *AASB Not-for-Profit Entity Standard-Setting Framework*.

Where an arrangement involves the transfer of goods or services, we take the view that the requirements of AASB 15 should be applied to those arrangements. However, where the arrangement does not involve the transfer of good or services, then we would be supportive of exploring whether an alternative income recognition approach that considers the costs the grant is intended to compensate meets the needs of users.

We note such an approach continues to require identification of arrangements that would fall in the scope of AASB 15 and those that do not, highlighting the need for more guidance on identifying sufficiently specific performance obligations as noted in our response to questions in Topic 1.

Topic 4: Principal v agent, including the appropriate recognition of financial liabilities

Regarding the recognition of financial liabilities, if an NFP entity's only obligation is to transfer funds received to other entities, do you have any comments on:

11. the determination of whether the entity is a principal or an agent?

12. whether differences in application exist in concluding whether an NFP entity is a principal or an agent? If there are differences in application, do they significantly affect the comparability of financial statements?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

In our experience the recognition of a financial liability is not directly tied to the determination of whether an entity is a principal or an agent. Whether AASB 9 *Financial Instruments* is applicable is a matter of fact depending on the contract in question. Similarly, if an entity is an agent, it is not necessarily the case that a financial liability will be recognised for the agent's involvement in the arrangement.

The AASB did not issue additional guidance on principal versus agent considerations for NFP entities, instead relying on the guidance the IASB developed (AASB 15.B34-B38). In our experience this guidance is sufficient, and the complexities come from the judgements required in certain facts and circumstances.

Rather, we consider that clearer guidance on identifying financial liabilities in typical NFP income arrangements should be the focus of the AASB's efforts in this regard. We note the AASB recently deferred its consideration of Illustrative Example 3A (IE3A) in concluding its review of stakeholder feedback on ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases*. We strongly encourage the AASB to review IE3A as part of its post-implementation review as it is contributing to significant divergence in practice. We believe the source of confusion arises from the example conflating the following topics:

- principal versus agent;
- contractual obligations surrounding the maintenance of the principal amount and option of the alumnus to recall the funds; and
- obligation to fund scholarships from uncertain future income generated on the principal amount if such income is in excess of maintaining the grant's real value.

IE3A does not consider each issue in isolation and provides limited explanation for why a financial liability was concluded to exist in the example. As indicated previously, we do not think further guidance on principal versus agent alone would resolve the issues with IE3A.

Our recommendation is that the AASB revise IE3A with a clearly defined fact pattern that focuses on identifying whether a financial liability "related amount" arises from the

entity's obligations under the arrangement, providing analysis with reference to AASB 132 *Financial Instruments: Presentation*.

We also recommend the AASB include a contrasting example where no recognition of financial liability arises, with explanation as to why not.

Topic 6: Termination for convenience clauses

Regarding accounting for termination for convenience clauses:

17. do you support view (a) or view (b) regarding recognising a liability in relation to unspent funds? Please explain your rationale, including references to Australian Accounting Standards. Examples to illustrate your responses are also most helpful;

18. do you have any other comments? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

In our experience a termination for convenience clause included in a grant agreement that may be exercised at the grantor's discretion gives rise to a financial liability. The scope of AASB 132 does not distinguish between contractual elements that could be considered 'protective' or 'substantive', as is the case with AASB 10 *Consolidated Financial Statements*. Therefore, applying such an approach by analogy would not be appropriate in our view.

We note the Board discussed termination for convenience clauses at its 11-12 November 2020 meeting. As indicated in the Staff analysis presented at that meeting, the only reference to assessing the substance of contractual terms is with reference to the classification of a financial instrument.

We concur with Staff views that this issue is relevant to both not-for-profit and for-profit entities applying AASB 9. Accordingly, this matter is best referred to the IASB for its consideration.

Where the termination clause is recognised as a financial liability in accordance with AASB 132 and the terms of the clause are such that only *unspent* funds are to be returned, the liability would be progressively derecognised as funds are spent. This is because the grantor's right to recall (and the recipient's obligation to return) the funds is extinguished over time as described in AASB 9.3.3.1.