Dr. Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via submission portal: https://www.aasb.gov.au/current-projects/open-for-comment

9 March 2022

Dear Keith,

RE: Exposure Draft 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases*

I am responding to your invitation to comment on Exposure Draft 318 on behalf of PwC.

We welcome that the Board is aiming to address concerns raised by stakeholders, including ourselves, in relation to the implementation of AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities* by issuing ED 318. We support the AASB's proposals

- to add Illustrative Example 7A to AASB 15 if it addresses issues that stakeholders have raised regarding upfront fees received that are in the scope of AASB 15, subject to minor recommendations noted in the appendix to this letter; and
- relating to concessionary leases, and we consider the disclosure requirements to be adequate for both private and public sector not-for-profit entities.

However, we do not believe that the AASB's proposed amendments in Illustrative Example 3A.1 in AASB 1058 address the issues identified in the AASB's June 2021 Agenda Paper 16.1 in relation to the application of the principal vs agent guidance in AASB 15 and the recognition of financial liabilities. In our view, the main question to be addressed is whether entities that receive and pass through funds should account for the funds received and monies spent on a gross or net basis. Specifically, in the situation where the entity has significant discretion over the funds (who receives, how much they receive, when they receive, specified uses) but is not able to retain the funds. In our experience, most entities recognise grants and payments on a gross basis.

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Given the potentially significant change to current accounting practice, the issue of whether not-for-profit organisations should recognise income on a gross or net basis should be more fulsomely considered as part of the post-implementation review of AASB 1058 rather than being dealt with through illustrative
Given the potentially significant change to current accounting practice, the issue of whether not-for-profit organisations should recognise income on a gross or net basis should be more fulsomely considered as part of the post-implementation review of AASB 1058 rather than being dealt with through illustrative
examples. Should the Board decide that an entity cannot be a principal with respect to the collection and distribution of funds, transition guidance may be required.

We further note that a change in accounting treatment may reduce the size of many charities which means that they may no longer be required to lodge any financial reports with the Australian Charities and Not-for-profits Commission (ACNC) and will no longer be subject to audit or review. These matters should be further explored as part of the post-implementation review.

Detailed feedback on these matters is provided in the appendix to this letter.

I would welcome the opportunity to discuss our firm’s views at your convenience and to provide feedback for the post-implementation review of AASB 1058.

Yours sincerely,

Erin Craike
Partner

Appendix

Proposed amendments to AASB 1058 - Illustrative Example 3A.1

We do not believe that the AASB's proposed amendments to Illustrative Example 3A.1 (IE 3A.1) address the concerns raised by stakeholders in relation to the application of the recognition and measurement requirements of AASB 1058. We have the following concerns with the example:

- *Principal vs. Agent* - AASB Agenda Paper 16.1 for the June 2021 Board meeting (Agenda Paper 16.1) noted that there is no specific guidance for not-for-profit entities in Appendix F of AASB 15 in relation to the principal vs agency distinction. According to the feedback in the paper, this lack of guidance has led to confusion and diversity with respect to the accounting for revenue on a net or gross basis and the circumstances under which a financial liability must be recognised.

  This issue is most relevant for entities that receive donations which are 'passed through' the entity and ultimately end up with another entity, for example foundations that receive cash donations and then provide funding to successful applicants. In many cases, the foundation's sole objective is to receive and distribute funds in its "ordinary course" of business. The foundations often determine to whom funds are distributed through soliciting, reviewing and approving applications, as well as determining how much they distribute to each applicant, when funds are distributed and for what purpose funds are to be used. However, they are unable to retain the funds. It is not clear how to apply the principal vs. agency guidance to the situation of receiving and distributing funds.

  In our view, given AASB 1058 is an income standard, we recommend that any example focus on whether or not income and expense should be recognised on a gross or net basis, as opposed to whether there is a financial liability. We consider that this change in focus would better address the feedback in Agenda Paper 16.1. However, as this would potentially result in changes in practice, we believe that it would be more appropriately dealt with through the post-implementation review of AASB 1058.

- *Change to current practice and transition provisions* - understand that if a financial liability is recognised, the not-for-profit entity would not recognise income and expense on a gross basis. We recommend that journal entries should be included in any example to make this clear if that is the case. Current practice would be that most not-for-profit entities commonly recognise income for the full amount of donations received even if they also recognise expense and a financial liability for any obligation to transfer payment. If the presentation of profit and loss is to change, we recommend that the Board considers whether transition relief may be warranted. This is particularly relevant for not-for-profit entities that have not been recognising financial liabilities on receipt of a donation but have instead recognised gross income and expenses.

- *Accounting for any financial liability* - It is unclear in the currently drafted amended IE 3A.1 why there is no discounting if the liability is paid over 10 years and why the financial asset is equal to the financial liability. If IE 3A.1 remains focussed on the AASB 9 accounting treatment, then we recommend expanding the fact pattern to address this (e.g. by including clarification that the amounts are payable on demand). It is also not clear how the conclusion may change if the cash scholarships were not "directed and approved by the alumnus" annually but there still remained an obligation of the recipient to use the fund for scholarships.

- *Impact on reporting requirements* - If the Board proceeds with issuing guidance that may result in organisations no longer recognising gross grant income and expense for payments to beneficiaries, we encourage the Board to discuss the impact of these amendments with the ACNC. As the financial reporting thresholds are based on revenue, we expect several charities may no longer meet the reporting thresholds for providing financial statements to the ACNC should they change their accounting treatment. They may also no longer be required to have their financial statements audited or reviewed.

Proposed amendments to AASB 15

In respect of the AASB's proposal to add Illustrative Example 7A (IE 7A) to AASB 15, we concur that the proposed amendment provides an appropriate illustration of the application of the recognition and measurement requirements of AASB 15. We do not object to the example being included if it addresses concerns of stakeholders. However, we do not consider that it provides additional guidance or clarity beyond what is required by AASB 15.

If the example is included, we recommend the AASB clarifies in the Accounting Treatment section that, based on the terms and conditions of the contract, the revenue recognition period does not extend beyond the initial contract period as the customer either does not have an option to renew the contract, or if there is an option to renew, the option does not provide the customer with a material right. The accounting treatment section in the currently drafted IE 7A concludes that revenue is recognised over the contractual period of two years. We are concerned that preparers will default to recognising revenue over a fixed contract period where there is one and not adequately consider any renewal options and potential material rights if this is not clarified in the example.

Lastly, we note that this example is similar to the upfront school fee and waiting list fee examples that are discussed in the Staff FAQs (FAQ 10 and 11 in AASB Staff FAQs: AASB 15 *Revenue from Contracts with Customers*, AASB 1058 *Income of Not-for-Profit Entities* and AASB 16 *Leases*). We recommend the Board consider including all examples together in one place to allow them to be easily accessed, compared and contrasted. Section 3 of the FAQs could be modified to include the accounting for up-front fees more generally, with schools being an example.