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/

27 March 2023

RE: AASB Invitation to Comment ITC 50 *Post-implementation Review - Income of Not-for-Profit Entities (ITC 50)*

I am responding to your invitation to comment on the Post-implementation Review (PIR) of *Income for Not-for-Profit Entities* (AASB 1058) on behalf of PwC. We welcome the Board seeking feedback in relation to this standard.

Having worked with a number of clients, we acknowledge that there have been complexities in applying the new income model which, at times, requires a significant amount of judgement. However, this is not unusual with new standards and is a result of our principles rather than rules-based approach to standard setting. Further, we acknowledge the efforts of the AASB staff to perform outreach and issue FAQs to support stakeholders in some of the more challenging areas. The principles underlying AASB 1058 were discussed at length by the AASB and decisions were carefully made to ensure the outcome is a standard which is consistent with the underlying conceptual framework. As such, we are supportive of the model and do not recommend that the Board go back to the drawing board and start anew. However, we agree that that the AASB may consider:

- monitoring the IPSASB's project on *Revenue without Performance Obligations* to consider whether any finalised outcomes are relevant for consideration in the longer term and
- clarifying key areas where there are more pervasive areas of diversity which may be more easily addressed. We highlight two of the areas that we consider most significant, being the impact of pass-through arrangements and termination for convenience clauses on income recognition. Our detailed feedback on these issues and recommendations are in the Appendix to this letter.

Lastly, we note that some of the difficulties applying the model are due to the technical language used in the standard as well as the fact that guidance is included in multiple places (i.e., AASB 15, AASB 1058 and FAQs). While we appreciate that this is not easily fixed, we recommend considering whether the guidance could be better consolidated into one place. At a minimum, certain guidance (in particular the flowcharts) might be incorporated into the standard. Also, the AASB might consider teaming with the ACNC in developing a "plain English" guide.

We have not identified any significant practice issues in relation to the topics in ITC 51, *Post-implementation Review of Not-for-Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements* and as such, have not prepared a submission.

We have appreciated the opportunity to discuss our firm's views with the AASB team. Please reach out to me should you have any further questions.

Yours sincerely,

Erin Craike
Partner

Appendix

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

We have seen situations where not-for-profit entities receive funding that must be passed through to other not-for-profit entities. This is common for various foundations. Often, the not-for-profit is entitled to retain a small percentage to cover its internal administrative costs. While the not-for-profit must pass the funds through, they may have some discretion as to when, how much and to whom the funds are provided.

In these situations, it may be that a financial liability or provision arises for the amount that is required to be passed through and income is only recognised for the administrative fee allowed to be retained. This is because AASB 1058 only permits recognition of income for the residual amount, after any other related standards are applied. AASB 1058 has therefore brought greater focus to the need to consider AASB 9 *Financial Instruments* and AASB 137, *Provisions, Contingent Liabilities and Contingent Assets* and whether there is a liability that must be recognised on day 1 when the funding is received.

In our experience, entities consider it most transparent if they disclose income at the full amount of funds received, especially where they have some discretion as to whom, how much, when and for what purpose the funds must be contractually passed on. We would recommend that Example 3A be amended to be more clear as to the flow on impacts of recognising a financial liability on income recognition and/or including a further example of a foundation where a provision might be required to be recognised because of the constructive obligation to pass funds through. This might create greater consistency and draw attention to the need to consider whether a liability exists and the flow on impacts to income recognition.

While the principal vs agent considerations may be useful, we do not consider that the current guidance in AASB 1058 would allow them to be applied to cash transactions. Recognising income and expense on a gross basis where a liability exists would also be inconsistent with paragraph 9. However, if there is a desire for greater transparency of the cash flows coming in and out of a NFP and this cannot be achieved with additional disclosures, then the AASB could consider whether the principal vs agent guidance could be used to determine under which circumstances grant inflows and related outflows should be shown gross or net.

We further note that there is a possibility that a number of NFP entities may fall outside the ACNC reporting thresholds if they recognise income only for the administrative fee. If the standard is not amended to avoid this outcome, the Government could revisit the reporting thresholds that are used in the *Australian Charities and Not-for-profits Commission Act 2012* for the purpose of the size test. For example, it could replace the revenue test with operating payments (used in NZ for bottom tier and defined as “the total amount of any payment (including grant payments and income tax payments, where applicable), other than a capital payment”).

pwc

Topic 6: Termination for convenience clauses

The second area where we see diversity is in relation to whether termination for convenience (TFC) clauses are considered to create a financial liability, and the flow-on impact on the timing of income recognition.

While TFC clauses may be similar or identical across agreements, we see diversity in the judgements made as to whether such clauses create a financial liability. These judgements have a direct impact on when income is recognised. The issue is most relevant to entities that apply AASB 1058 because:

- If the arrangement is in scope of AASB 15, entities generally refer to the guidance for refund liabilities in AASB 15, paragraph 55 and to AASB 9; and
- Private sector entities account for grants under AASB 120 and recognise a liability for repayment of grants per AASB 120, paragraph 32.

While we note this as an area of diversity, we acknowledge that this has been previously considered by the AASB. At that time (November 2020), the Board decided that:

- the standards provide sufficient guidance to assess the effect of TFC clauses; and
- if further interpretation was required, the issue would need to be raised with the IFRS IC as it involves interpretation of IFRS equivalent standards.

If the AASB desires to improve consistency in application, the AASB might consider incorporating some of the analysis in the November 2020 paper into the staff FAQs as it provides a good basis for assessing the impact of TFC clauses -- as well as raises awareness of the need to consider. If an FAQ were added, the AASB might further consider reminding preparers of the need to disclose significant judgements made in the context of the impact of TFC clauses on the timing of income recognition per AASB 101, paragraph 122.