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Dear Keith

**Comment Letter - ITC 50 *Post-implementation Review Income of Not-for-Profit Entities***

We are pleased to respond to the AASB's Invitation to Comment (ITC) 50 in respect of the board's review accounting for income of not-for-profit (NFP) entities following the December 2016 issuance of AASB 1058 *Income of Not-for-Profit Entities*, AASB 2016-7 *Amendments to Australian Accounting Standards – Deferral of AASB 15 for Not-for-Profit Entities* and AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities*.

Overall, we believe that the application of AASB 1058 has led to NFPs being subject to more diversity in practice, more subjectivity, and more creativity in applying Australian Accounting Standards, allowing varying interpretation of funding agreements by entities to achieve preferred accounting outcomes.

AASB 1058 therefore has not achieved its objective in providing relief from the complexity and judgment of the previous versions of AASB 1004.

In our opinion, the application of the revised framework has resulted in confusion and inconsistencies in recognition of income, adversely impacting both preparers and users of financial statements. We believe that common issues with the framework arise from the complexity and subjectivity of judgement required in the assessment of the "sufficiently specific" performance obligation criteria to determine income recognition in line with the framework under either AASB 15 or AASB 1058. Previous attempts by the AASB to provide further guidance to NFPs through additional illustrative examples and other releases have not resolved this issue.

We also believe that application of AASB 1058 has created an additional financial burden for NFPs, both from professional and legal fees for advisory services to assist in applying the standards and increased audit fees in auditing what is often a significant risk area. In some cases, entities have incurred legal fees in redrafting contracts to avoid undesirable accounting outcomes. An additional burden has been placed on finance teams and board members, with their focus being redirected from operational matters to the application of accounting standards.

For the reasons above, we believe that the next steps taken by the AASB should involve standard setting activity to revise AASB 15 Appendix F and AASB 1058. We do not believe that further guidance or illustrative examples will address the fundamental issues.

We set out more detailed reasons for our position below, in response to the AASB's specific and general matters for comment in the Invitation to Comment.

We would be pleased to discuss our firm's views further with you. Please contact me on 08 9261 9374 should you wish to discuss our comments.

**Ralph Martin**  
National Technical Director  
RSM Australia

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## RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]

**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 believe that the term “sufficiently specific” is ambiguous and has resulted in diversity in practice where the same obligations can be deemed as both sufficient and non-sufficient in specificity by experienced practitioners. In our opinion, differences in application are widespread due to the ambiguity of the term and guidance provided in AASB 15 Appendix F.

The “conditions” noted in paragraph AASB 15 F20 (a) – (d) describe the basic elements of performance obligations and give minimal guidance to the user on how to exercise judgement over whether a transfer of goods and/or services would constitute a sufficiently specific performance obligation in practice. Paragraphs F22 and F24 do little to further clarify how judgement should be applied.

For example, in ITC 50 topic 1 obligations example (f) it is easily arguable that this example is *not* sufficiently specific in line with the guidance given in AASB 15 Appendix F as the “provision of counselling services to adolescents affected by mental health issues over 24 months” is in our opinion non-specific, with significant discretion available to determine what such services entail by the provider. In this scenario we would consider further detail required to define as “sufficiently specific”, such as the number of hours of services to be provided, qualifications of staff providing services, or a minimum level of on-demand service to be achieved.

Furthermore, we have noted multiple examples where preparers have ended up attempting to defer income by analysing contracts or grant acquittal terms in such a way as to tenuously identify specific outputs that can be deemed “sufficiently specific performance obligations”, even when those outputs are secondary to the overall purpose of the funding, or do not reflect the actual intent of the arrangement.

**RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]**

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.

We appreciate that detailed guidance in respect is somewhat difficult due to the variety of theoretical potential performance obligations, however given that the majority of NFPs will receive funding with potential sufficiently specific obligations from grants, then additional grant-aligned advice and examples should be available to entities to assist consistent application and consideration.

Given the substantial volume of guidance already in place, we believe that adding yet more illustrative guidance would effectively be an admission that the Standard is either over-complex, or leading to outcomes that do not appear appropriate to preparers.

Our view is therefore that, while guidance may be marginally helpful, only standard setting activity can address the fundamental problems raised by the current requirements of AASB 15 Appendix F and AASB 1058.

Regarding the term “identified specifications” in AASB 1058 paragraph 15(a), do you have any comments about:

5. the application of the term in practice?
6. the extent of specificity needed for a contract to meet the requirements of AASB 1058 paragraph 15(a)?
7. whether differences in application exist because of the use of the term identified specifications?

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 opinion, similarly to the application of AASB 15 Appendix F's “sufficiently specific” consideration the term “identified specifications” is vague and with limited guidance, however application in practice is largely less ambiguous.

In practice, where NFPs receive funds for the entity to acquire or construct a non-financial asset, such as a building, the respective funding agreements typically contain wording which would be considered by most users of the standard to exceed the threshold of “identified specifications” when assessed by similarly knowledgeable individuals as a result of funding typically being allocated in subject to formal plans from the receiving entity.

8. In addition to the existing illustrative examples in AASB 1058, is there any other guidance that would help you determine when to recognise revenue following the transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity? If so, please provide details of the guidance and explain why you think it would be useful.

We have no further comment on this matter.

## RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]

- 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.**

In our opinion the fundamental issue and frustration faced by the majority of NFP financial statement preparers in recognising revenue is the obligation to recognise all income on receipt where the requirements of AASB 15 are not met. While other forms of income are affected, grant income is the area which continues to cause most concern.

This remains the case even if the funding is ring-fenced for a particular purpose which will be delivered over an extended period, and even where there is an obligation to refund any unspent funds to the grantor at the termination of the grant. This means that there is often significant mismatch between the timing of the recognition of income, and the recognition of the related expense, with the income and the related spending occur in different financial years, potentially resulting in a large surplus being recognised initially, followed by a deficit in subsequent periods.

As a result financial reporting under the revenue standards has become a burden for NFPs, where income recognised under AASB 1058 in the financial statements is often recognised over a period reflecting expenditure or length of funding period in the management accounts requiring additional work to prepare annual financial statements.

Furthermore, the immediate recognition requirements of AASB 1058 result in decreased understanding of financial information presented to users of the statements, with particular impact on non-financially experienced persons.

We would also highlight the inconsistency with the treatment of government grants in the for-profit sector under AASB 120, which requires matching between the recognition of grant income and the related costs for which the grants are intended to compensate.

## RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]

**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 use 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 are 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 suggest the most appropriate alternative approach would be fundamentally consistent with the requirements of AASB 120 for grant income. Under this approach, NFPs would recognise grant income on a systematic basis in line with expected timeline of delivery of services or incurring of associated costs of services to complete, regardless of the timing of payment delivery.

A similar approach should apply to any other source of funding where the funder has an enforceable right to determine the manner in which the funding is spent, for example through an acquittal process, or a refund obligation for unspent funds.

In our opinion this change in recognition policy and removal of the ambiguity of determining whether sufficiently specific performance obligations exist would reduce the compliance burden of judgement on NFPs and allow recognition policies in line with the conceptual framework and AASB 15 and AASB 120 as applied to for-profit entities.

**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 opinion, determination of whether an entity is acting principal vs agent for NFPs is less subjective than the question of application of the sufficiently specific criteria and is in line with determination for for-profit entities under AASB 15 despite limited example guidance.

We agree with other stakeholders that to address the accounting treatment of such transactions an NFP entity must first assess if it is considered a principal or an agent and therefore whether funds received and monies spent should be recognised on a gross or net basis.

Similarly, where funds are held for disbursement to others, an entity must assess whether it has control of the funds in question, or whether it has instead entered into a custodial relationship, in determining whether to recognise an asset.

**RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]**

**13. In relation to determining whether an NFP entity is a principal or an agent, do you have examples of specific scenarios where there are practical challenges and application issues?**

**If so, please provide details of the complexities associated with this determination, such as the level of discretion the entity has in determining to whom funds will be passed, and illustrate the relevant circumstances, their significance and the prevalence of any differences in application.**

As noted above, we believe that this area has less diversity in practice than the application of "sufficiently specific" and therefore have not encountered situations where significant challenges occurred.

**14. Is there any guidance that would help you determine whether an NFP entity is a principal or an agent? If so, please provide details of the guidance and explain why you think it would be useful.**

We have no further comment.

**Do you have any comments regarding:**

**15. the accounting for grants received in arrears, particularly where some of the work to be funded by the grant is performed before the funding is received? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful;**

**16. whether differences in application exist in the accounting for grants received in arrears exists? If so, please provide examples that illustrate the relevant circumstances, their significance and the prevalence of any differences in practice.**

We note that the accounting treatment for grants received in arrears assessed as being in scope of AASB 1058 should recognise a financial assets when it has a contractual right to receive cash or another financial asset from the grantor in line with AASB 9 for work performed in line with the terms of the grant agreement in advance of payment by the grantor.

We reason that divergent views on recognition arising from stakeholders making what should be relatively straightforward judgements, such as whether financial asset recognition for grant income in arrears is appropriate and in line with AASB 9, have arisen due to confusion caused by the complexity of judgement required by AASB 1058 of whether sufficiently specific performance obligations are included in the grant agreements.

We believe that the apparent reluctance of some entities to recognise grants received in arrears as a financial asset, even where the recognition criteria of AASB 9 are clearly met, may arise less from concern about the recognition of a financial asset, and more from concern about having to recognise the associated income in a manner which does not match the recognition of the related expenses.



**RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]**

**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.**

We became aware of the use of “termination for convenience” clauses as a means to delay the recognition of revenue by some preparers and auditors several years ago.

Our view has been that such clauses are generally protective in nature, and therefore should not be used to justify the recognition of a financial liability at inception. In reaching this view, we were guided by AASB 1058.B14 which sets out the requirements in respect of refund obligations which can be avoided.

While termination for convenience clauses are unavoidable by the entity, our view is that they are generally protective in nature, and therefore in substance can usually be avoided by complying with both the strict terms and the funder's overall objectives for the grant. Therefore a financial liability should only be recognised when the clause is triggered by the funder, since until this time, no contractual obligation to deliver cash exists.

We would highlight that the diversity in practice in respect of termination for convenience clauses is just one example of the creativity of preparers in seeking to find any permissible way to defer income and recognise it in line with the related expenses.

- 19. Do you have any comments regarding the accounting for research grants (other than termination for convenience clauses, which are covered in Topic 6)?**

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

We have no further comment.

**Do you have any comments regarding:**

- 20. the subsequent accounting treatment of statutory receivables? If so, please provide your views, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful;**
- 21. whether the initial measurement of statutory receivables in accordance with AASB 9 added considerably to the workload of preparers and auditors – either on implementation of Appendix C to AASB 9 or subsequently? If so, please provide your views on the initial measurement requirements, relevant circumstances and their significance.**

We have no further comment.

**RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [ITC 50]**

<b>Examples to illustrate your responses are also most helpful.</b>	
<b>22. Does the application of AASB 1058 and AASB 15 by NFP entities adversely affect any regulatory requirements for NFP entities?</b>	We have no further comment.
<b>23. Does the application of AASB 1058 and AASB 15 by NFP entities result in major auditing or assurance challenges?</b>	<p>We believe that application of AASB 1058 has created an additional financial burden for NFPs, from fees for accounting advisory services to assist in applying the new standards; to increased audit fees in auditing what is often a significant risk area, and sometimes even legal fees in redrafting contracts to avoid undesirable accounting outcomes.</p> <p>Due to the significant additional level of judgement arising from the application of the standards additional burden has been placed on auditors, particularly in the assessment of sufficiently specificity of performance obligations in grant revenue, where considerable time is often required to review client judgements in line with grant terms and requirements of AASB 15 Appendix F.</p>
<b>24. Overall, do AASB 1058 and AASB 15 result in financial statements that are more useful to users of NFP entity financial statements?</b>	In our view we believe that the application of the standards has in many cases resulted in financial statements that are less useful to users, particularly where entities have been forced to recognise grant income on a cash basis. Such treatment is at odds with historic treatment and has in our experience led to frustration and misunderstanding for NFP leadership, particularly for non-financially educated persons, due to the incongruity of timing of funding and expenditure across periods and resulting accounting surplus/deficits which may arise.
<b>25. In your view, do the benefits of applying the requirements of AASB 1058 and AASB 15 exceed the implementation and ongoing application costs for NFP entities?</b>	In our view we strongly believe any benefits of applying do not outweigh associated costs and burden for NFP entities for the rationale outlined above. As noted, our view is that the standard changes are largely retrograde and significant changes are required.
<b>26. Are there any other matters that should be brought to the attention of the AASB as it undertakes this PIR on the accounting for income of NFP entities?</b>	We have no further comment.