Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M185
Topic:	**Tier 3 – Revenue/Income – Grants, donations and bequests**	**Agenda Item:**	11.4
		Date:	7 February 2022
Contact(s):	Carmen Ridley cridley@aasb.gov.au Maggie Man mman@aasb.gov.au Jim Paul jpaul@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Project Priority:** **Decision-Making:** **Project Status:**	High Low Initial deliberations

The objective of this paper

1 The objective of this staff paper is for the Board to **consider** the preliminary staff analysis, including options identified by staff for Tier 3 reporting requirements for income from grants, donations and bequests[1] of a not-for-profit (NFP) private sector entity.

2 This paper provides only a **preliminary** staff analysis and does not provide staff recommendations. Staff request the Board to confirm whether any further options need to be analysed by staff and any options that the Board does not wish to pursue further. Pending the decision made at this meeting, staff plan to bring further analysis on this topic to the April 2022 Board meeting.

3 This paper **does not** address the following elements of an NFP entity income measurement:

(a) *initial measurement of assets acquired for significantly less than fair value* — staff have sought preliminary feedback from the Not-for-Profit Project Advisory Panel on 19 January 2022 on possible approaches to the Tier 3 requirements and will bring the analysis and recommendations to the Board's April 2022 meeting;[2]

(b) *accounting for volunteer services* – this issue will be considered as part of the initial asset measurement element of income that staff plan to bring to April 2022 Board meeting; and

(c) *revenue from contracts with customers within the scope of AASB 15* – the decisions made on accounting for grants, donations and bequests in this paper will be used to inform future staff paper on this topic that staff plan to bring to May 2022 Board meeting.

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1 This paper considers grants, donations and bequests regardless of whether they would be accounted for in accordance with AASB 15 *Revenue from Contracts with Customers*, AASB 1058 *Income of Not-for-Profit Entities* or another standard.

2 Staff note that the matter of initial recognition was not raised as an area of focus during preliminary outreach of the project, and in line with the approach the Board agreed at its 4th August 2021 meeting to such topics, the proposed requirements would be primarily based on New Zealand *Public Entity Simple Format Reporting – Accrual (Not-for-Profit)* requirements.

Background and reasons for bringing this paper to the Board

4 At its 4 August 2021 meeting, the Board decided to consider the classification, recognition and measurement requirements concerning revenue and other income of a NFP private sector entities at a future meeting. Stakeholders' feedback discussing the challenges are mainly concerned with recognition and measurement requirements rather than disclosure, particularly given the Board's initiative on disclosure simplification effected through the issue of AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*.

5 The Not-for-Profit Private Sector Financial Reporting Framework Project Summary provides an overview of the Board's tentative decisions to date regarding the project.

6 Accounting for revenue and income was identified as one of the key areas for simplification based on the feedback from the preliminary outreach summarised in Agenda Paper 3.1 for the Board's 16-17 September 2020 meeting, and the Board agreed to include this topic as one of the key topics in the discussion paper at its 20-21 April 2021 meeting. Staff note that the forthcoming post-implementation review (PIR) of AASB 1058 and NFP guidance to AASB 15 may provide further information to improve accounting for income by NFP entities in general.

7 The Board may wish to wait to decide its preferred view on Tier 3 income accounting requirements only when the PIR further progresses. However, as the staff plan to analyse the PIR feedback in Q2 2023 and publish a feedback statement in Q4 2023, awaiting the outcomes of the PIR may further defer the completion of Tier 3 requirements if the Board would consider simplifications for Tier 3 entities at that stage. Staff also note that any decisions made as part of this project are made concerning the Tier 3 requirements development principles that give weight to the practicality, proportionality of cost and benefits for Tier 3 entities and their users and availability of the information to the entities. Accordingly, these decisions are made within the Tier 3 boundary and are not directly applicable for Tier 1/Tier 2 entities.

8 In the staff's view, the expected timing for considering feedback from the PIR aligns with the timing for the Board considering feedback on the forthcoming discussion paper (DP). Therefore, the feedback from the PIR is expected, in part, to assist the Board's deliberations in determining the next steps, including when and how to progress to an Exposure Draft.

9 On balance, whilst the Board's any preferred view in respect of income accounting should not pre-empt the PIR process, and recognising the PIR may have relevance to Tier 3, staff recommend the Board discuss potential options for income accounting simplification for Tier 3 entities in the DP and express its view on the preferred option if it decides to do so.

Question to Board members

Q1 Do Board members agree that the forthcoming Discussion Paper should discuss potential options for income accounting simplification for Tier 3 entities and express any preferred options, if the Board decides to do so?

If not, does the Board prefer to note in the Discussion Paper that it will await to consider any income accounting simplifications until the forthcoming PIR results are available in Q2 2023?

If not, what approach do Board members prefer to take?

Structure of this paper

10 This paper is structured as follows:

<u>*Current accounting requirements and whether there is a reason for the Board to address*</u>

(a) current requirements under Australian Accounting Standards (paragraphs 11 – 16);

(b) Australian legislative requirements (paragraphs 17 – 18);

(c) summary of approaches taken by selected other jurisdictions (paragraph 19);

(d) feedback from Australian stakeholders (paragraphs 20 – 28);

(e) findings from academic research and other literature (paragraphs 29 – 30);

Considering options for simplifications and staff analysis

(f) options for simplification (paragraphs 31 – 36);

(g) evaluation of options against Tier 3 principles (paragraph 37);

(h) next steps (paragraph 38).

Current requirements under Australian Accounting Standards

11 NFP private sector reporting entities are required to comply to Australian Accounting Standards such AASB 1058 *Income of Not-for-Profit Entities* and AASB 15 *Revenue from Contracts with Customers* when accounting for revenue and income (other standards provide requirements for particular types of the income, such as AASB 16 *Leases* and IFRS 9 *Financial Instruments*)

12 Given the scope and focus of this paper, a high-level summary of AASB 1058 requirements only has been provided below in paragraphs 13 – 16.

AASB 1058 Income of Not-for-Profit Entities – a high-level summary

13 AASB 1058 applies to transactions where the consideration to acquire an asset is significantly less than fair value principally to enable a not-for-profit entity to further its objects and the receipt of volunteer services.

14 An entity is required to apply the requirements of other Australian Accounting Standards (as relevant) to recognise an asset arising from a transaction from applying AASB 1058. Any related contributions by owners, increase in liabilities, decrease in assets, and revenue ('related amounts') are recognised in accordance with other Australian Accounting Standards (e.g., AASB 15). The excess between the initial carrying amount of an asset over the related amounts is recognised as income immediately.

15 Where an NFP entity receives a transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset that is to be controlled by the entity, the entity shall recognise a liability measured at the carrying amount of the financial asset received from the transferor over any related amounts for performance obligations under AASB 15. Income is recognised in profit or loss when the NFP entity satisfies its obligations under the transfer.

16 An NFP private sector entity may apply an accounting policy choice to elect to recognise volunteer services if the fair value of those services can be measured reliably, whether or not the services would have been purchased if they had not been donated. If recognised, volunteer services are recorded as an asset or an expense while the related amounts are recognised in accordance with the applicable Australian Accounting Standards. Any excess of the fair value of the volunteer services over the recognised related amounts is recognised as income immediately in profit or loss.

Australian legislation requirements

17 Staff have reviewed Australian legislation governing NFP entities to understand the current reporting requirements for revenue and income of an NFP entity and assess the potential impact of any simplifications of the income accounting:

- Some legislation establishes the financial reporting threshold that references **annual revenue** in accordance with the Australian Accounting Standards (e.g., *Australian Charities and Not-for-Profits Commission Act 2021,* Corporations Act 2001, NSW Co-operatives (Adoption of National Law) Act 2012).
- Other relevant Australian legislation establishes the financial reporting obligations of the entity using size thresholds referencing **gross receipts or total income** (e.g., Northern Territory *Associations Act 2003,* South Australia *Associations Incorporation Act 1985,* Queensland *Incorporated Associations Act 1981*).

18 While there may be differences in the NFP legislation determining the size thresholds for financial reporting requirements,[3] all NFP legislation requires that the financial statements present the financial performance of the entity in accordance with Australian Accounting Standards or an account of the income (and expenditure) of the NFP entity during the year. Therefore, changes to revenue and other income accounting may have an impact on whether an entity qualifies for a particular tier.

Summary of approaches taken by selected other jurisdictions

19 When considering this topic, staff had regard to the requirements that apply to smaller NFP entities of other jurisdictions.[4] The summary from our review is as follows:

Income type/Jurisdiction	Grants / donations with performance conditions	Grants / donations without performance conditions
IFRS for SME / UK FRS 102	Income recognised as conditions are met	Income recognised when entitled to the resource
NZ PBE Tier 3	Transactions with 'use or return' conditions - income recognised when conditions are met.	Income recognised when cash received.
UK Charities SORP	Income recognised as conditions are met	Income recognised when entitled to the resource
Singapore	Income recognised on delivery of specified level of service	Income recognised when entitled to the resource
HK SME FRF and SME-FRS	Income recognised over period necessary to match them with related costs they are intended to compensate on a systematic basis.	Income as received if purpose is to compensate for expenses incurred or for giving immediate financial support.

3 The Board has decided at its 24-25 February 2021 meeting not to specify application thresholds for tiers.

4 Staff considered the components of financial statements from the following selected jurisdictions: International United Kingdom – IFRS for SMEs, United Kingdom – FRS 102 *The Financial Reporting Standards applicable in the UK and Republic of Ireland* (FRS 102) – Section 1A small entities regime and Charities SORP (102) *Accounting and Reporting by Charities: Statement of Recommended Practice* (Charities SORP), New Zealand – *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit)* (NZ Tier 3), Canada – Part III of the Handbook Accounting Standards for Not-for-profit Organisations (Canada ASNFPO), Singapore – *Charities Accounting Standard, Hong Kong – Small and Medium-sized Entity Financial Reporting Standard* (HK SMEFRF & SME-FRS), and United States of America – Not-for-profit Entities (Topic 958) (US ASC NFP 958). Further information is provided in the supporting documents folder in Agenda paper 11.4.1.

Canada	Income recognised either in the same period as expenses incurred or using fund accounting	Income recognised when cash received.
US ASC NFP 958	If the agreement includes donor-imposed conditions, then income recognised as conditions are met.	Income recognised when cash received.
IPSASB ED 71	Income recognised as present obligations are met	Income recognised when recipient has control of the resources
IFRS4NPO (consultation paper)	4 alternatives provided for comment for non-exchange transactions: i. Use IFRS for SME concepts and principles ii. Use IAS 20 iii. Use IPSASB 23 iv. Use IPSASB 23 with exceptions.	

Feedback from Australian stakeholders

20 As part of the targeted outreach conducted by staff in 2020, staff received feedback that stakeholders supported the Board in developing a 'simpler balance sheet'. Amongst other aspects, staff understood this to extend to stakeholder support for simpler recognition and measurement requirements. In addition, at the AASB NFP Project Advisory Panel meetings held on 18 May 2021,[5] panel members provided the following initial feedback concerning possible Tier 3 accounting simplifications for revenue and income recognition:

The distinction between recognition of revenue from contracts with customers and recognition of other income from providing goods or services to members of the community

21 Several members of the Project Advisory Panel suggested simplifying the income recognition requirements for Tier 3 reporting by NFP private sector entities. They:

(a) noted that Australian Accounting Standards applicable to NFP entities require a mainly two-step approach to applying income recognition requirements, in which the entity considers first whether a transaction or arrangement falls within the scope of AASB 15 *Revenue from Contracts with Customers* and, if not, then applies the 'other income' recognition requirements of AASB 1058 *Income of Not-for-Profit Entities*; and

(b) suggested setting out the Tier 3 recognition requirements for revenue and other income in a single integrated section of the Tier 3 Standard(s).

22 A related comment made by some members of the Project Advisory Panel was that various NFP private sector entities (including Tier 3 NFP entities) encounter difficulties with identifying when arrangements fall within the scope of the revenue recognition requirements of AASB 15 or the income recognition requirements of AASB 1058. Their concern extends beyond the different locations of income recognition requirements, to the way in which those requirements interact.

23 One Panel member suggested retaining the 'transfer of control of goods or services' revenue recognition principle in AASB 15 for contracts with customers but to simplify the requirements of AASB 15 for application by Tier 3 NFP entities. In relation to recognising revenue from contracts with

5 Refer Agenda paper 3.4 *Not-for-Profit Project Advisory Panel minutes from 18 May 2021 meeting* from the 20-21 June 2021 AASB meeting.

customers, Panel members expressed little support for reverting to the 'significant risks and rewards of ownership' criterion in superseded Australian Accounting Standard AASB 118 *Revenue*.

24 A few Panel members suggested simplifying AASB 1058 for application by Tier 3 NFP entities by replacing its residual approach of applying AASB 15 first, and instead including a simpler test of whether a transfer of an asset to a Tier 3 NFP entity is accompanied by a 'use or return' condition (which is the criterion specified in the New Zealand Tier 3 requirements for public benefit entities). These comments were conditional on the retention of the AASB 1058 income recognition model (incorporating by reference the requirements of AASB 15).

Immediate recognition of income

25 Some other Panel members expressed concern that AASB 1058 requires immediate recognition of many transfers as income in circumstances in which the NFP entity considers:

(a) it has an obligation to spend or use the transferred asset in future periods; or

(b) the transfer relates to one or more future periods (e.g., the entity receives a triennial grant without meeting the criteria for identifying a performance obligation under AASB 15).

26 Those Panel members noted that many Tier 3 NFP private sector entities (i.e., preparers) want income recognition to be more consistent with the 'matching' principle, under which income is recognised in the periods for which it was provided (usually concurrently with related expenses). This preference reflects preparers' views (to remove differences between statutory and management reporting and resulting duplicity) and the concerns of funding/oversight bodies (users) whose expectations of the underlying basis of income recognition often differ from the basis applied. This view is consistent with the comments made in the NZ T3 PIR where many respondents preferred revenue deferral to be more widely permitted. Some of these respondents raised concerns that the current "use or return" condition requirement in the Tier 3 Standard is too restrictive. It was noted that, as a consequence of this requirement, some funders no longer offer multiyear funding arrangements.[6]

27 Several Panel members at the meeting held on 19 January 2022 confirmed that matching was their preferred option for income recognition for Tier 3 NFP entities. Several Panel members would not support recognition of grants as immediate income (as one member suggested to revert back to approach applied under AASB 1004 *Contributions* prior to the introduction of AASB 1058) as it was not simple to decide the control aspect and further, this would not be useful to the users how the entity will fund required services in future.

Feedback from narrow-scope revenue for NFP project[7]

28 A number of the stakeholders consulted as part of the narrow-scope NFP revenue project who were preparers or auditors of Tier 3 NFP entities commented on the complexities and challenges encountered in ongoing implementation of AASB 15 and AASB 1058. In particular, the concepts below are relevant to this project:

(a) Matching revenue with expenses is difficult to achieve under the current standards, which causes confusion when explaining financial results to stakeholders.

6 Agenda item 2.2 Donation and grant revenue recognition in the Tier 3 Standard, NZASB Board meeting 21 September 2021

7 Agenda item 16.1 AASB 1058 Income of Not-for-Profit Entities targeted outreach, AASB Board meeting 21-22 June 2021

(b) Identifying the relevant accounting standards to determine appropriate income recognition methodology is time-consuming with little perceived benefit.

(c) Lack of resources and often less skilled finance professionals in the Tier 3 NFP entities are disproportionately exposed to the abovementioned complexities.

Findings from academic research and other literature

29 AASB Research Report 16 notes that for Not-for-Profit sector, there is a body of literature supporting the use of accrual accounting in providing useful information to encourage donors and assure or support regulators. Accurate financial reporting is rewarded by donors to NFP entities and utilised when allocating donations to NFP entities. Some research recommended differentiated regulation according to the main source of revenue[8] whilst other noted specific issues unique to the NFP entities such as non-reciprocal or non-exchange transfers from donors that have conditions or restrictions attached and valuing the contributions of volunteers (albeit in the context of appropriateness of the conceptual framework).[9]

30 The most recent relevant research staff have identified is *Decision Usefulness: A re-examination of the information needs of non-profit GPFR users* (D. Gilchrist, C. Furneaux, A. West, Y. Zhang, 2021)[10] that identified through a series of interviews with stakeholders, identified complexities in the accounting standards leading to variability in reporting and reducing the understanding of users noting AASB 15 and AASB 1058 as adding complexity where it was not required, including:

- the requirement to recognise income from grants or procurement process where the outcomes related to the purpose of the funding were not sufficiently clear to allow for the staged recognition as the expenses were incurred and potential cause to threaten resourcing opportunities due to profitable performance;
- the recognition of the receipt of capital funds for purchase assets and bequests (including the appropriate timing of recognition) as income may distort the financial performance of the entity; and
- support amongst users, preparers and auditors for the return to the matching principle or simpler accounting standards that could help users and those charged with governance better understand the accounting for an entity's revenue and income.

Options for simplification

31 With reference to the flowchart in Appendix A of Agenda Paper 11.1 for this meeting on approaches to simplification, staff have identified five options for Tier 3 reporting requirements on the accounting for income from grants, donations and bequests. The staff analysis considers current practice in Australia and international jurisdictions, feedback received from stakeholders, and the findings summarised in paragraphs 20 to 30 above. In the main, the options focus on simplifying the AASB 1058 approach, which requires assessment of the requirements of other Standards before recognising the income, including assessing the specificity of any conditions attached to a transaction. Many Tier 3 entities with unsophisticated systems and low resources report their progress on grants through an acquittal system. Accordingly, one consideration in simplification is identifying a method that is consistent with the existing systems and processes.

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8 *Differentiated regulation: the case of charities,* Cordery, C. J., Sim, D. & van Zijl, T. (2017)

9 *The non-profit accounting mess* (Anthony, R. N. 1995)

10 This research was presented at the AASB Research Forum 2021

32 Staff have summarised the options below and note that the language used in this paper is based on underlying sources and would be articulated using simpler and more plain English words for the Tier 3 requirements.

Income recognition model (options) for Tier 3 NFP entities (income in the scope of AASB 1058 and outside the scope of another standard, primarily grants, donations and bequests)

33 The options below consider the income recognition model for NFP entities where the income is outside the scope of another standard (primarily grants, donations and bequests), i.e., for example, it excludes income relating to interest, dividend and rental, since these will be covered in other elements of the NFP FRF project:[11,12]

(a) **Option A**: Apply unchanged the requirements for recognition of other income set out in AASB 1058. In this paper, this model is abbreviated as the "AASB 1058 model" (noting the pending outcome of forthcoming PIR). This option would not provide simplification compared to current reporting requirements other than the simplification of language and potentially disclosures.

(b) **Option B**: Simplify the requirements for the recognition of other income set out in AASB 1058 by also identifying liabilities (and therefore deferring income recognition) whenever either:

- there are enforceable conditions that the entity must spend or otherwise use the transferred assets as directed or return them to the transferor; or
- the transferor can enforce the entity's promise to transfer economic resources by other means.

In other words, under Option B, the condition is enforceable, but not limited to cases in which enforceability is achieved through a refund right over the transferred asset, and means that the need to assess whether the contract contain sufficiently specific performance obligations in order to defer income is largely removed. In this paper, this model is abbreviated as the "enforceable conditions model".

(c) **Option C**: Modify the requirements for the recognition of other income set out in AASB 1058 along the lines proposed in IPSASB ED 71 *Revenue without Performance Obligations* (February 2020) by also identifying liabilities (and therefore deferring income recognition) for performance obligations that are not owed to customers, e.g., obligations to perform specified activities or incur eligible expenditure. In this paper, this model is abbreviated as the "enforceable activities/expenditures model". Similarly to Option B, this would simplify currently required assessment under AASB 1058 whether conditions result in sufficiently specific obligations.

(d) **Option D**: Simplify the requirements to allow either expense or time-based matching. This approach would be similar to the approach applied in AASB 120 *Accounting for*

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11 Staff have also considered a further option being a model when the period in which income is recognised in respect of transferred assets is based on judgement unless the transfer results in a contract with customer, a lease liability, a financial instrument or a provision. Staff did not include this model in the options above because in staff's view, this model would not necessarily result in the simplification for Tier 3 entities and likely would not result in the comparable financial statements.

12 Another option that staff did not analyse further was "risk and reward" approach adopted by the superseded AASB 118. This was on reflection from the preliminary feedback that this option does not provide additional user value and is not simpler compared to current AASB 1058 requirements. Therefore, staff focused on the options identified including those around "matching" principle noting that whilst Options B, C and D might be similar, the income recognition pattern may differ depending on distinction between "conditions" (Option B), "activities/expenditures" (Option C) and "expense/time passage" in particular set of circumstances.

Government Grants and Disclosure of Government Assistance (but extended to all transfers, not just government grants), under which unsatisfied conditions that defer income recognition include unenforceable conditions. This option could also include cases when the stipulation by a transferor was provided in respect of a particular period. Therefore, in this paper, this model is abbreviated as the "expense/time-based matching model". This option further simplifies the income recognition without need to assess sufficiently specific criterion and depending on the matching method allowed (that is outside the scope of this paper), a further simplification can be achieved (e.g., if a time-based or a straight-line matching method is applied).

(e) **Option E**: Under this model, the entity records revenue when there is a legal right to receive cash (either now or sometime in the future). There is no consideration of whether there are any conditions including "use or return". This option further simplifies income recognition as it is recognised at the time of receipt of cash (or a receivable). In this paper, this is referred to as the 'cash-based model'.

34 A summary of the options and application to three high-level examples has been illustrated below to allow Board to review a snapshot of the differences in the models.

Table 1: High level overview and illustrative application

	Model				
	Option A - AASB 1058	**Option B - Enforceable conditions**	**Option C – Enforceable activities/expenditures**	**Option D - Expense/time-based matching**	**Option E - Cash-based**
High-level overview of the models	As is under AASB 1058	Remove the requirement for the contract to contain sufficiently specific performance obligations – the contract conditions need only to be enforceable for deferral of income.	Same as option B, but enforceability extends to provision of specified activities rather than only refundability of transferred funds or other economic outflows.	Apply the expense or time-based matching model where revenue is deferred when conditions in the agreement are met.	Income is recognised once the entity has established a right to receive cash (i.e., on receipt of cash or a receivable) irrespective of any conditions attached to the funding.
Application of the models to the following scenarios:					
Entity receives operational funding in current year to be spent in the following financial year	Immediate income	If enforceable, then defer income If not enforceable – immediate income	Immediate income (because no specific activities or expenditures identified)	Defer income and recognise over time to match expense or time lapse	Immediate income upon funds receipt
Entity receives funds to employ staff and fund their salaries	Immediate income	If enforceable, then defer income If not enforceable – immediate income	Defer income	Defer income and recognise over time to match expense or time lapse	Immediate income upon funds receipt
Entity receives funds to extend its current services to a new region for a limited period	Likely to be immediate income unless performance obligation extension is sufficiently specific and the contract is enforceable.	If enforceable, then defer income If not enforceable – immediate income	Defer income	Defer income and recognise over time to match expense or time lapse	Immediate income upon funds receipt

35 Staff have analysed the support for and arguments against Option A to Option E in Table 2 below.

36 Staff note that some of the arguments in support for or against a particular option may be equally applicable to NFP Tier 1 or Tier 2 entities. However, this paper focusses on Tier 3 entities only and possible income recognition models for these entities from the simplification perspective, including the balance of the satisfaction of the principles for development of Tier 3 requirements that are analysed in Table 3 considering factors such user needs with the cost to the preparers and availability of the information already used by management.

Table 2: Summary of possible options and analysis for Tier 3 – grants, donations and bequests income recognition model

Option A: AASB 1058 model Apply unchanged the requirements for recognition of other income set out in AASB 1058. Thus, income other than revenues from contracts with customers and interest would be recognised immediately upon recognising an inflow of an asset (unless a related lease liability, financial instrument or provision exists) except to the extent that the entity has an enforceable obligation to use a transferred financial asset to acquire or construct a recognisable non-financial asset to be controlled by the entity (AASB 1058, paragraphs 9, 10 and 15 – 17).	
Support for the approach	**Arguments against the approach**
• Transaction neutral and consistent with Tier 1 and Tier 2 entities facilitating movement of professionals between Tiers. • Consistent with the principles in the Conceptual Framework. • Differentiates between enforceable and unenforceable obligations.	• Income is recognised immediately in many cases which is different from the intention of the purpose of the funds. • The model does not leverage management information used in decision-making. • The model is complex and Tier 3 entities with limited are spending significant time and effort to determine the appropriate income treatment under the accounting standards for compliance purposes. • Determining the appropriate standard (AASB 15 or AASB 1058) has caused confusion and inconsistencies in reporting revenue due to difficulties in identifying whether promises in agreements are sufficiently specific performance obligations. • Current requirements are not necessarily flexible to deal with the different arrangements entered into by Tier 3 entities. • Stakeholder feedback indicates the cost of ongoing implementation exceeds the perceived benefits.

Option B: Enforceable conditions model

Modify the requirements for the recognition of other income set out in AASB 1058 by also identifying liabilities (and therefore deferring income recognition) whenever:

- there are enforceable conditions that the entity must spend or otherwise use the transferred assets as directed or return them to the transferor (the requirement of the New Zealand Tier 3 requirements for public benefit entities (paragraph A62)); or
- the transferor can enforce by other means the entity's promise to transfer economic resources (using the guidance on enforceable promises in AASB 15, Appendix F, paragraph F20, for example, the transferor can enforce specific performance by the entity of the conditions attached to the transfer).

In this regard, the IFRS for SMEs requires income from grants with performance conditions to be recognised when the performance conditions are met this seems similar to identifying liabilities when either (i) or (ii) is satisfied.

Support for the approach	Arguments against the approach
• Arguably proportionate response to concerns raised by stakeholders. • Removes sufficiently specific criteria which stakeholders report as being difficult to apply. • Closely aligned with NZ Tier 3 requirements. • Differentiates between enforceable and unenforceable stipulations. • Increases the understandability of financial statements as the liability more closely aligns with the stakeholder view of a liability. • Stakeholder feedback indicates that assessing enforceability of a contract is not too onerous, thereby costs would be reduced compared to Option A.	• Removal of sufficiently specific means that a liability can be recognised when it may be difficult to determine when the obligation is satisfied – leading to potentially arbitrary revenue recognition. • Enforceable criteria may be too narrow a principle for deferral. • Stakeholders may be confused about the enforceability of constructive obligations. • Departure from Tier 1/Tier 2 requirements, although certain liabilities would overlap. • The model may not sufficiently leverage management information used in decision-making.

Option C: Enforceable activities/expenditures model

Modify the requirements for the recognition of other income set out in AASB 1058 along the lines proposed in IPSASB ED 71 *Revenue without Performance Obligations* (February 2020) by also identifying liabilities (and therefore deferring income recognition):

(i) to the extent that the entity has an enforceable obligation to use a transferred financial asset to acquire or construct a non-financial asset, *whether recognisable or unrecognisable*, to be controlled by the entity (e.g., unlike with the AASB 1058 model, the non-financial asset to be acquired could be unrecognised intellectual property retained by the entity from research);

(ii) whenever the entity does not incur a performance obligation to a customer but incurs an obligation in a binding arrangement to either:

(A) perform a specified activity (e.g., construct a hospital or conduct a form of research for the entity's benefit)—this obligation seems to overlap that in (i) above but is described separately in IPSASB ED 71; or

(B) incur eligible expenditure (i.e., incur expenditure for a specified purpose that is not an identifiable specified activity covered by (A)), e.g., funding is provided to a university to employ a marketing manager to promote the university's courses to overseas students (ED 71, para 18, 20 & AG25 – AG27).

Support for the approach	Arguments against the approach
• Increases the understandability of financial statements as the liability more closely aligns with the user view of a liability. • Presumably less costly than existing AASB 1058 model for Tier 3 entities as directly points to the activities/expenditures to consider.	• Departure from Tier 1 / Tier 2 requirements although certain liabilities would overlap. • Initial costs needed to understand the new models and terminology not currently present in AAS. • Judgement required to understand whether the deferral criteria are satisfied.

Option D: Expense matching model

Apply the principles of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* (but extended to all transfers, not just government grants). Where transfers are made to the entity in return for compliance with certain conditions, the transfers would be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the transfers are intended to compensate. Conditional transfers related to depreciable assets are recognised as income concurrently and commensurately with depreciation expense recognised in respect of those assets. All other transfers outside contracts with customers (and that do not give rise to other liabilities such as lease liabilities, financial instruments or provisions) would be recognised as income immediately upon recognising the transferred assets.

The main differences between this model and the models in Options A, B and C are that:

(i) AASB 120 does not stipulate that the conditions over the transferred assets must be enforceable. Conceivably, a grant received on the condition that the grant money is used to acquire a non-financial asset would be accounted for as giving rise to a liability without the grantor being able to enforce the acquisition, if the grantor would discontinue the future provision of grants to the entity; and

(ii) AASB 120 specifies that government grants related to assets, including non-monetary assets recognised at fair value, may, as a presentation alternative to recognising a 'deferred income' liability, deduct the amount of the grant in arriving at the carrying amount of the asset. Applying this alternative involves recognising the effect of the grant in profit or loss as a reduced depreciation expense. Where the grant is for the entire value of the asset, applying this alternative would in effect result in non-recognition of the granted asset.

Support for the approach	Arguments against the approach
• Consistent with existing IFRS standard – IAS 20 (AASB 120) • Expected to be less costly to apply than existing AASB 1058 model for Tier 3 entities removing need to assess enforceability and specificity of conditions. • May increase the understandability of financial statements as the liability more closely aligns with the stakeholder view of a liability. • Leverages management information used in decision-making due to the use of matching. • Proportionate response to issues raised by stakeholders.	• Does not support transaction neutrality for NFP tiers but would be consistent with for-profit treatment • A liability arising from unenforceable obligations may result in a departure from Conceptual Framework • Enforceability is a key characteristic of a liability, and this has been removed in this option which may result in difficulty for users to identify a liability from a general obligation. • Allows entity an option to offset funding received against a related asset purchased or constructed which may result in non-recognition of assets and reduced information for users.

Option E: Cash-based model Under this model, the entity recognises income once the right to receive cash is established (i.e., on receipt of funds or notification of a receivable) regardless of any stipulations in the agreement.	
Support for the approach	**Arguments against the approach**
• Least costly model since an entity is not required to consider any terms and conditions within the agreement to determine accounting treatment.	• No transaction neutrality • Does not reflect the pattern of transfer of specific goods/services funded by the contract • Causes mismatch between receipt of funds and corresponding expenditure for all contracts which overlap a financial reporting period • Conflicts with stakeholder feedback in respect of user needs. • Would likely increase volatility of results as income and expenses are more likely recognised in different periods compared to current requirements of AASB 1058.

37 The options above have been assessed for their alignment against the Tier 3 principles outlined in Appendix A of agenda paper 11.1 to this meeting and the results have been summarised in Table 3 below.

Table 3: Applying Tier 3 Principles to options identified

Tier 3 Principle	**Model**				
	Option A - AASB 1058	**Option B - Enforceable conditions**	**Option C – Enforceable activities/ expenditures**	**Option D -Expense/time-based matching**	**Option E- Cash-based**
(1) Compatible with AASB NFP Standard-Setting Framework	***Strong*** • Transaction neutral • No significant departures from CF	***Moderate*** • No significant departures from CF • Some overlap with liabilities recorded under AASB 1058	***Moderate*** • May result in some liabilities which do not meet the definition of a liability in the CF • Some overlap with liabilities recorded under AASB 1058	***Moderate*** • Would result in liabilities which do not necessarily meet the definition in the CF • Information is not transaction neutral	***Weak*** • Unlikely consistent with CF • More weight towards cost for preparers beyond “undue cost or effort” • Lack of perceived benefit based on feedback from users and preparers
(2) Tier 3 GPFS provide useful information for resource allocation decisions by Tier 3 users	**Mixed** • Same basis as Tier 1 and 2 – provides consistency • May cause confusion for some Tier 3 users e.g. focusing on grant acquittal	**Mixed** • Some contracts will be deferred, and others recognised immediately	**Mixed** • Some contracts will be deferred, and others recognised immediately	**Moderate** • Recognition of revenue likely to reflect the intention of the grantor and income recorded in the same period as the expense intended to be compensated	**Weak** • May cause confusion for some users as whilst simplest option, most distinct from acquittal reporting
(3) Consistent with principles for Tier 2 (‘desirable but not warranted’)	**Strong** • Identical to Tier 2	**Moderate** • Moderate departure – more revenue deferred	**Moderate** • Moderate departure – more revenue deferred	**Weak** • Significant departure – revenue deferred also in cases when no enforceability	**Weak** • All revenue recognised upfront irrespective of conditions

Tier 3 Principle	Model				
	Option A - AASB 1058	**Option B - Enforceable conditions**	**Option C – Enforceable activities/ expenditures**	**Option D -Expense/time-based matching**	**Option E- Cash-based**
(4) Where possible, leverages information management uses	**Mixed** • Some information needed not ordinarily prepared by management	**Mixed** • Some information needed not ordinarily prepared by management	**Mixed** • Some information needed not ordinarily prepared by management	**Strong** • Reflects the reporting to the funding providers and leverages from existing information, e.g., acquittals.	**Mixed** Information regarding receipt is prepared, however inconsistent information to that recorded in grant acquittals
(5) Benefits exceed costs	**Weak** • Additional information to be prepared • Stakeholder confusion regarding reported results	**Moderate** • Less costly than existing treatment, however additional information to be prepared	**Moderate** • Less costly than existing treatment, however additional information to be prepared	**Strong** • Leverages from information currently prepared. • Consistent with feedback from stakeholders	**Mixed** • Lower costs incurred however inconsistent treatment is confusing for users

Question to Board members	
Q2	Do Board members agree with the completeness of options identified by staff for income recognition (outside the scope of other standards)? If not, which additional models should be included?
Q3	Are there any options identified by staff which Board do not consider viable and therefore should not be subject to any further work?
Q4	Do the Board members agree with the arguments for and against each option? If not, which options do the Board wish staff to further analyse?

Next steps

38 Subject to the Board's decisions at this meeting, staff will continue analysis of the possible approaches for accounting for income to be considered for Tier 3 requirements and will seek further feedback from the Not-for-Profit Project Advisory Panel. Staff plan to bring further analysis and recommendations for the Board to consider at its April and May 2022 meetings.

Question to Board members	
Q5	Do Board members agree with the proposed next steps?