AASB Invitation to Comment

ITC 50
November 2022

Post-implementation Review – Income of Not-for-Profit Entities

Comments to the AASB by 31 March 2023

Australian Government

Australian Accounting Standards Board

How to Comment on this AASB Invitation to Comment

The AASB is seeking comment by 31 March 2023.

Formal Submissions

Submissions should be lodged online via the "Current Projects – Open for Comment" page of the AASB website (www.aasb.gov.au/current-projects/open-for-comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

ISSN 1320-8713

AASB REQUEST FOR COMMENTS

Introduction

The Australian Accounting Standards Board (AASB) is undertaking a post-implementation review (PIR) of the requirements in Australian Accounting Standards regarding the accounting for income of not-for-profit (NFP) entities.

This Invitation to Comment (ITC) aims to seek feedback from stakeholders that enables the AASB to conclude on a pronouncement's overall effectiveness and efficiency in meeting its original objectives, including whether a pronouncement remains appropriate.

The *AASB Due Process Framework for Setting Standards* (paragraph 7.15.2) sets out that a PIR involves:

(a) review of research that is relevant to the subject matter under review, including research by AASB staff and academics;

(b) collation of issues received by the AASB prior to the commencement of the PIR;

(c) stakeholder consultation to seek feedback on implementation issues and other views on the pronouncement;

(d) consideration of the feedback received by the AASB;

(e) publication of the findings of the PIR; and

(f) consideration of any recommendations for changing the pronouncements, which would require the AASB to undertake a separate standard-setting consultation process.

A PIR is not intended to reconsider the underlying pronouncement in its entirety. Instead, it acknowledges that the consultation and due process during the development of a pronouncement are not a substitute for the practical application of the requirements in the issued pronouncement. For example, when the requirements in an issued pronouncement are applied in practice, unexpected issues may arise, such as a pronouncement being more difficult or costly to apply than what was expected. There might also be situations where a pronouncement unintentionally results in divergence in practice. This divergence could be due to differing judgements in applying the requirements, unclear requirements or new or emerging transactions that were not contemplated when a pronouncement was developed.

The PIR process comprises three broad phases: planning, outreach, and feedback and next steps.

Planning phase

The planning phase establishes the scope of matters to be considered by the PIR. These matters are identified through a review of project documentation published when the pronouncements were issued, a review of academic research and other literature, targeted outreach with selected stakeholders and consideration of matters raised by stakeholders during the implementation of the pronouncements and subsequently.

Outreach phase

Following the issue of an ITC, during the outreach phase, the AASB will actively engage with stakeholders to seek feedback on the matters identified. This outreach may include meetings with financial statement users, preparers, regulators, professional service firms, professional bodies and academics and formal written responses from stakeholders.

Feedback and next steps phase

The AASB considers all feedback received during the outreach phase and prepares a feedback statement after the formal PIR consultation process. After considering feedback received during the consultation process, the AASB will decide whether:

- no action is required;
- additional educational material is needed; or
- standard-setting is required.

Where additional educational material or standard-setting is warranted, this would be addressed under a separate AASB project.

We need your feedback

Comments are invited about your experience in the accounting for income of not-for-profit entities on matters considered in this ITC by 31 March 2023. Stakeholder feedback plays an important role in the AASB's standard-setting process. The AASB regards supportive and non-supportive comments as essential to a review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Comments are most useful if they indicate the specific paragraph of the pronouncement to which they relate, contain a clear rationale, are supported by evidence and, where applicable, provide a suggestion for an alternative approach or additional support the AASB could consider providing to stakeholders. Respondents need not answer all the questions. When answering the questions, respondents are asked to consider the effect of the requirements on:

(a) the quality and consistency of financial statements and whether they provide relevant and reliable information about an entity's financial position and performance;

(b) comparability, both from period to period for an entity and between entities; and

(c) the costs to users and preparers of financial information.

Background to Income of Not-for-Profit Entities

In December 2016, the AASB issued 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*[1] and AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities*.[2] As a result, AASB 1058 and AASB 15 *Revenue from Contracts with Customers* applied to NFP entities for annual reporting periods beginning on or after 1 January 2019.

Before the issue of AASB 1058 and AASB 15, the recognition and measurement requirements for transactions giving rise to income depended on whether the transaction was reciprocal or non-reciprocal. The accounting for income arising from reciprocal transactions was predominantly addressed in AASB 118 *Revenue* and AASB 111 *Construction Contracts*.

1 AASB 2016-7 deferred the effective date of AASB 15 for NFP entities by 12 months to annual reporting periods beginning on or after 1 January 2019 instead of 1 January 2018.

2 AASB 2016-8 added Appendix F *Australian implementation guidance for not-for-profit entities* to AASB 15 and Appendix C *Australian implementation guidance for not-for-profit entities* to AASB 9 *Financial Instruments*.

The accounting for income arising from non-reciprocal transactions was addressed in AASB 1004 *Contributions*.

In practice, the AASB observed that determining whether a transaction was reciprocal or non-reciprocal was not always straightforward. Entities found it challenging to determine whether approximately equal value had been provided in exchange with the other party or parties to the transfer. Entities argued that, in many instances, the immediate recognition of income in a non-reciprocal transaction did not faithfully represent the underlying financial performance of the entity. Diverse interpretations existed, with some entities recognising transactions with return obligations and specified performance outcomes as reciprocal transactions and some not.

At the time, stakeholders were particularly concerned about the income recognition requirements that applied to grants, appropriations and other transfers of assets made on the condition that the NFP entity delivers goods or services to nominated third parties. The AASB heard that preparers found it difficult to discuss financial information with grantors and donors and challenging to explain why an NFP entity needed additional resources when the financial statements indicated no such need. Users noted they did not think the financial statements reflected the economic reality of an NFP entity’s financial circumstances. Having regard to this feedback, the AASB decided to undertake a project to conduct a fundamental review of the income recognition requirements applying to NFP entities.

In May 2014, the International Accounting Standards Board completed developments in the accounting for revenue with the issue of IFRS 15 *Revenue from Contracts with Customers*. Consistent with the AASB’s adoption of International Financial Reporting Standards (IFRS Standards), IFRS 15 was issued in Australia as AASB 15 *Revenue from Contracts with Customers*. However, as IFRS Standards are written from a for-profit perspective, the AASB needed to determine whether amendments and guidance would be required to enable NFP entities to apply the equivalent Australian Accounting Standard, AASB 15. In addition, the AASB noted that applying the performance obligation approach to revenue recognition adopted in AASB 15 and using a broader concept of customer might resolve some of the concerns noted with AASB 1004.

The AASB also observed that various Australian Accounting Standards required an NFP entity to recognise assets received at fair value (or current replacement cost, in relation to inventories) only where the asset had been acquired for no or nominal consideration (e.g. AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*). The AASB perceived a gap in the accounting requirements for transactions where an asset had been acquired for consideration below market value but more than nominal. The AASB noted that under the recognition and measurement rules at that time, an entity would be likely to have measured the asset acquired at the amount of the consideration transferred and not have recognised any income on the transaction. The AASB considered that, in many instances, such transactions were unlikely to be conceptually different from those where no or nominal consideration was transferred. The AASB consequently decided to consider accounting for such transactions as part of the income of NFP entities project.

AASB 15 Appendix F

After conducting a comprehensive review of AASB 15 to determine where additional NFP guidance might be required, the AASB issued integral guidance to assist NFP entities with applying the requirements of AASB 15. This guidance is set out in Appendix F to AASB 15 and includes addressing:

(a) how NFP entities should apply terminology used in AASB 15;

(b) when an agreement with another party creates enforceable rights and obligations; and

(c) how to identify when performance obligations exist.

In addition to issuing Appendix F, the AASB also made amendments to the body of AASB 15:

(a) to require that transfers that enable an entity to acquire or construct a non-financial asset to be controlled by the entity be accounted for in accordance with AASB 1058, not AASB 15; and

(b) to clarify that any contract that is not enforceable or does not contain sufficiently specific performance obligations is not within the scope of AASB 15 for NFP entities.

If a transaction is outside the scope of AASB 15, the recognition and measurement of income arising from the transaction may instead be specified by another Standard, such as AASB 1058.

AASB 1058

AASB 1058 clarifies and simplifies the income recognition requirements that apply to NFP entities in conjunction with AASB 15. The requirements of AASB 1058 are intended to more closely reflect the economic reality of NFP entity transactions that are not contracts with customers. The timing of income recognition depends on whether such a transaction gives rise to a liability or other performance obligation (a promise to transfer a good or service) or a contribution by owners related to an asset (such as cash or another asset) received by an entity.

AASB 1058 applies when an NFP entity receives volunteer services or enters into other transactions where the consideration to acquire an asset is significantly less than the fair value of the asset principally to enable the entity to further its objectives. In the latter case, the entity recognises and measures the asset at fair value in accordance with the applicable Australian Accounting Standard (e.g. AASB 116). Upon initial recognition of the asset, AASB 1058 requires the entity to consider whether any other financial statement elements (called related amounts) should be recognised, such as:

(a) contributions by owners;

(b) revenue, or a contract liability arising from a contract with a customer;

(c) a lease liability;

(d) a financial instrument; or

(e) a provision.

These related amounts are accounted for in accordance with the applicable Australian Accounting Standard. If the transaction is a transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity (i.e. an in-substance acquisition of a non-financial asset), the entity recognises a liability for the excess of the fair value of the transfer over any related amounts recognised. The entity recognises income as it satisfies its obligations under the transfer, similarly to income recognition in relation to performance obligations under AASB 15.

If the transaction does not enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity, then any excess of the initial carrying amount of the recognised asset over the related amounts is recognised as income on recognition of the asset.

When an entity receives volunteer services and can reliably measure the fair value of those services, the entity may elect to recognise the services as an asset (provided the relevant asset recognition criteria are met) or an expense. Local governments, government departments, a general government sector and a whole of government are required to recognise volunteer services if they would have been purchased if not provided voluntarily and the fair value of those services can be measured reliably.

What we have heard so far

Since the issue of AASB 1058 and the related AASB 15 NFP Australian implementation guidance, the AASB has become aware of many implementation problems raised by stakeholders. Following this feedback and after gaining an understanding of the prevalence and magnitude of the concerns raised, the AASB has issued:

(a) AASB 2018-4 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Public Sector Licensors*;

(b) AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities*;

(c) AASB 2019-6 *Amendments to Australian Accounting Standards – Research Grants and Not-for-Profit Entities*;

(d) AASB 2019-8 *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases*; and

(e) AASB 2022-3 *Amendments to Australian Accounting Standards – Illustrative Examples for Not-for-Profit Entities accompanying AASB 15*.

AASB staff also prepared educational material to support implementation and application by NFP entities. This includes FAQs, key facts documents and webinars.

Main findings from the planning phase

In undertaking the planning phase of this PIR, the AASB understands that implementation problems continue to exist in practice. The main findings from the planning phase of this PIR have been summarised in Topics 1 to 8.

Structure of this Invitation to Comment

This ITC includes 26 questions for respondents and is structured as follows:

- Topic 1: Sufficiently specific criterion and the legal interpretation of agreements;
- Topic 2: Capital grants;
- Topic 3: Difference between management accounts and statutory accounts and alternative revenue recognition models;
- Topic 4: Principal v agent, including the appropriate recognition of financial liabilities;
- Topic 5: Grants received in arrears;
- Topic 6: Termination for convenience clauses;
- Topic 7: Accounting for research grants;
- Topic 8: Statutory receivables; and
- AASB General Matters for Comment.

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

Current requirements

One of the two criteria for determining which Standard applies to the recognition of income of NFP entities is identifying whether a contract has sufficiently specific performance obligations.

AASB 15 paragraph F20 states "A necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is sufficiently specific to determine when the obligation is satisfied. Judgement is required to assess whether a promise is sufficiently specific. Such judgement takes into account any conditions specified in the arrangement, whether explicit or implicit, regarding the promised goods or services, including conditions regarding the following aspects:

(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."

AASB 15 paragraph F22 further states "Whether a promise is sufficiently specific so as to qualify as a performance obligation is assessed separately for each promise and will depend on the facts and circumstances. No specific number or combination of the conditions noted in paragraph F20 need to be specified in an agreement for the promise to be sufficiently specific. In addition, there may be other conditions that need to be taken into account in applying the judgement above that may indicate the promise is sufficiently specific."

Feedback

Feedback from stakeholders suggests that the term sufficiently specific is unclear and there is confusion in practice about how the term should be applied.

Example

For example, an NFP entity receives grant funding to employ a staff member for the next two years to deliver services to community recipients in line with the NFP entity's objectives.

The two views in practice regarding the appropriate accounting treatment of this grant are:

(a) the requirements of the grant are considered sufficiently specific. Therefore, the grant is within the scope of AASB 15 and the recognition of revenue should be deferred until the employee costs are incurred; or

(b) the requirements of the grant are not considered sufficiently specific. Therefore, the grant is within the scope of AASB 1058, revenue is recognised on receipt of the grant funding and employee costs are recognised over the two-year period of the grant as they are incurred.

Stakeholders indicated that because determining whether the sufficiently specific threshold is met can be a matter of judgement, differences in application can exist regarding how to account for contracts with similar terms and conditions. In some cases, it will be clear that the obligations of a contract are sufficiently specific. In other cases, it will also be clear that a contract is not sufficiently specific. However, there are likely many possible variations where judgement will be required to determine whether a contract is sufficiently specific. For example:

Obligations of the contract	Is the contract sufficiently specific, using the factors in AASB 15.F20?
(a) Spend the money in accordance with the entity's objectives.	No. The contract is not sufficiently specific as there is no detail about the type or quantity of services, the recipients or the time frame over which the services should be provided.
(b) Provide counselling services.	No. While the type of services to be provided is identified, there is no detail about the quantity of services, the recipients or the time frame over which the services are to be provided. Therefore, the contract is not considered sufficiently specific.
(c) Provide counselling services over the next 24 months.	Unclear. While there is detail regarding the type of services and the specified period, there is no detail about the recipient and quantity of services to be provided. The importance of specificity about the recipient of the services and the quantity of services to be provided is a matter of judgement.
(d) Provide counselling services in Melbourne for the next 24 months.	May be sufficiently specific. While the agreement specifies that counselling services are to be provided, the location and the time frame of the services to be provided, there is no specific detail about the nature or quantity of the counselling services.[3] However, the importance of specificity about the nature and quantity of the services is a matter of judgement.
(e) Provide counselling services in relation to mental health in Melbourne over the next 24 months.	May be sufficiently specific. While the agreement specifies the type of services to be provided, the location and the time frame, there is no specific detail as to whom the services are to be provided.[4] However, the importance of specificity about the service recipient is a matter of judgement.
(f) Provide counselling services to adolescents affected by mental health issues in Melbourne over the next 24 months.	Yes. The entity has little discretion over the type, quantity, recipient and location of services.

3 Similar to IFRS 15 Illustrative Example 25 regarding the provision of asset management services for five years.
4 Similar to IFRS 15 Illustrative Example 18 regarding access to a health club for 24 months.

Obligations of the contract	Is the contract sufficiently specific, using the factors in AASB 15.F20?
(g) Provide monthly counselling sessions to adolescents affected by mental health issues in Melbourne over the next 24 months.	Yes. The entity has little discretion over the type, quantity, recipient and location of services.[5]
(h) Provide 400 counselling sessions to adolescents affected by mental health issues in Melbourne over the next 24 months.	Yes. The entity has little discretion over the type, quantity, recipient and location of services.

Some stakeholders have also expressed concerns that 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 seems to be a much higher threshold than a legal interpretation of when an entity would breach the requirements of an agreement and not satisfy relevant performance obligations.

Given the differences in application arising in practice regarding whether an agreement is sufficiently specific for financial reporting purposes, stakeholders are concerned that the comparability of NFP entity financial statements may be reduced.

Questions for respondents

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.

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.

5 Similar to IFRS 15 Illustrative Example 13 regarding monthly payroll processing services.

Topic 2: Capital grants

Current requirements

Where an NFP entity is a party to a transaction that includes a transfer to enable the entity to acquire or construct a recognisable non-financial asset to be controlled by the entity, AASB 1058 requires the entity to recognise a liability for the excess of the fair value of the transfer over any related amounts recognised and to recognise income as it satisfies its obligations under the transfer. Such transfers are often referred to as “capital grants”.

In accordance with AASB 1058 paragraphs 15–17, a transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset for its own use is one that:

(a) requires the entity to use that financial asset to acquire or construct a non-financial asset to **identified specifications** [emphasis added];

(b) does not require the entity to transfer the non-financial asset to the transferor or other parties; and

(c) occurs under an enforceable agreement.

Illustrative examples 9 and 10 attached to AASB 1058 illustrate two different revenue recognition patterns for such transfers. Both of those examples assume that the identified specification criterion is met. However, there are likely many possible variations where judgement will be required to determine whether that criterion is met. For example:

Obligations of the contract	**Does the contract require the entity to use the financial asset to acquire or construct a recognisable non-financial asset to identified specifications as required by AASB 1058.15(a)?**
(a) A hospital receives a cash grant to acquire 16 intensive care hospital beds.	Yes. The agreement specifies the quantity and type of beds to be acquired.
(b) A school receives a cash grant to build an early learning (EL) centre on the entity’s land to the standard specified by government regulations applicable to EL programs. The EL centre must include two rooms.	Yes. The entity must build an EL centre with at least two rooms on the entity’s land and the EL centre must be built to regulations required by the government.
(c) A school receives a cash grant to build an EL centre on the entity’s land to the standard specified by government regulations applicable to the EL programs.	Likely to meet the identified specifications requirement. While there is detail regarding the location of the EL centre and the requirement for it to be built to government regulations, there is no detail about the size or composition of the EL centre. However, the importance of specificity about the size or composition of the EL centre is a matter of judgement.

Obligations of the contract	Does the contract require the entity to use the financial asset to acquire or construct a recognisable non-financial asset to identified specifications as required by AASB 1058.15(a)?
(d) A school receives a cash grant to build an EL centre to the standard specified by government regulations.	Unclear. While there is detail regarding an EL centre being built to government regulations, there is no detail about the location, size or composition of the EL centre. The importance of specificity about the EL centre's location, size or composition is a matter of judgement.
(e) An NFP entity with a single objective receives funding to construct a building to perform its operations.	Unclear. The entity will need to use judgement to determine whether the identified specifications criterion is met. Depending on the circumstances of the entity, such as a narrow or broad entity objective, additional detail may be required.
(f) A local council receives a government grant to build roads.	No. While there is detail about the purpose of the grant, there is no detail about the location of the roads, the length of the roads, minimum construction standards and the expected timing of construction. Therefore, the contract is not considered to meet the identified specifications criterion.
(g) An NFP entity receives a cash grant to construct a building.	No. The agreement does not meet the identified specifications criterion as there is no detail about the location or size of the building, minimum construction standards and the expected timing of construction.

Feedback

Stakeholder feedback suggests that because there is no guidance to explain how specific the identified specifications need to be for a contract to meet the requirement of AASB 1058 paragraph 15(a), there are divergent views about how much detail is required. Further, whether the identified specifications criterion is met affects the accounting and associated revenue recognition for such transactions, with the result that differences in practice in applying the criterion may decrease the comparability of NFP entity financial statements.

Questions for respondents

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.

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.

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

Current requirements

AASB 1058 and AASB 15 contain specific requirements for recognising income of NFP entities. In some cases, entities are required to recognise income on receipt, whilst expenses are recognised when incurred, which could be in a subsequent reporting period or periods.

Feedback

Feedback from some preparers indicated that recognising income on receipt for some agreements is unhelpful for users of the NFP entity's financial information. For example, where an agreement is not within the scope of AASB 15, entities may be required to recognise income on receipt. However, in some cases, the entity believes activities are still to be performed. Where this is the case, some NFP entities are preparing internal reports based on the activities carried out rather than in accordance with Australian Accounting Standards (i.e. entities are recognising revenue based on when expenses are incurred) because this information is perceived to be what those charged with governance and management of the entity find most useful.

Feedback also indicated that a management-preferred basis (management accounts) is often used when preparing financial information for donors unless the information is prepared for statutory purposes. It is also understood that most acquittal statements for funding received are prepared on a cash basis.

Some stakeholders also noted that where funds are received, particularly in the form of a grant, it is their view that because certain activities have to be performed, recognising revenue based on when expenses are incurred would provide more useful information to users. Further, they argue that matching revenue and expenses is consistent with AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*, which applies only to for-profit entities.

Questions for respondents

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 use the inflows of resources;[6]

    (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;[7]

    (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;[8] or

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6 AASB Discussion Paper *Development of Simplified Accounting Requirements (Tier 3 Not-for-Profit Private Sector Entities)* paragraph 5.182.

7 International Public Sector Accounting Standard IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* paragraph 7: definitions of stipulations on transferred assets and conditions on transferred assets.

8 AASB 120 paragraph 12.

(d) where the outflows of resources are incurred in accordance with the requirements set out in a binding agreement.[9]

If so, please provide your views on your preferred alternative(s) above or another alternative approach.

9 IPSASB Exposure Draft ED 71 *Revenue without Performance Obligations* paragraph 10: definition of eligible expenditure.

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

Current requirements

The accounting for revenue differs depending on whether an entity is a principal or an agent as this determines whether revenue is presented on a gross or net basis. A principal (i.e. an entity that will provide goods or services) recognises the gross amount paid by the customer as revenue and records a corresponding expense for the commission or fee it has to pay to any agent in addition to the direct costs of satisfying the contract. However, an agent (i.e. an entity whose role is to arrange for another party to provide the goods or services) recognises as revenue the commission or fee earned for facilitating the transfer of goods or services.

AASB 1058 includes illustrative example 3 to illustrate the accounting treatment where an entity's only obligation is to transfer funds to other entities. AASB 15 includes general guidance to help entities determine whether they act as a principal or an agent. However, no specific NFP guidance was added in AASB 1058 to assist NFP entities in determining in which capacity they are acting.

Feedback

Stakeholder feedback suggested that further clarification is required regarding the accounting treatment of financial instruments under AASB 1058, particularly whether to recognise a financial liability if an entity's only obligation is to transfer funds received to other entities. Some stakeholders suggested that AASB 1058 should include:

(a) an example with facts and circumstances where the recognition of a financial liability is appropriate, with an explanation; and

(b) a contrasting example where no recognition of a financial liability is required, explaining why not.

Stakeholders expressed concerns that the existing illustrative examples may lead to diversity in recognising financial liabilities. Further, stakeholders were also concerned that illustrative example 3A attached to AASB 1058 does not conclude whether any financial liability is recognised and, if so, what amount should be recognised.

Examples

Foundation

A foundation that provides funding and support for other charitable organisations by providing them with grants has a charter that outlines the foundation's charitable objectives. The charter states that funds raised by the foundation will be directed to other charitable organisations on a best endeavours basis. The activity of raising and distributing funds is the only activity of the foundation.

Following the principles of illustrative example 3A,[10] stakeholders have suggested it is unclear whether the foundation should recognise a financial liability for any funding raised that will be directed to other charitable organisations. This is because the illustrative example does not provide guidance on the principal/agent determination.

10 Illustrative example 3A illustrates the accounting treatment for an endowment received by a university where most of the income generated from the principal amount is required to be applied towards a specific purpose (providing scholarships to students). Illustrative example 3A concludes the endowment is accounted for under AASB 9, in accordance with paragraph 9 of AASB 1058, with any difference between the financial asset recognised (being the endowment received) and a related financial liability also to be recognised under AASB 9. Paragraph 10 of AASB 1058 does not apply.

For example, if the foundation is a principal, it would recognise revenue for all funds raised. However, if it is an agent, it would recognise a liability for the funds that will be distributed to other charitable organisations and recognise revenue only for amounts that the foundation will retain (if any) (e.g. to cover administration expenses).

Where differences in application exist in practice, this will reduce the comparability of NFP entity financial statements.

University

A university receives funding that needs to be applied to a specific purpose, such as the payment of scholarships to students. The funding includes terms stipulating how associated interest income from investing the funds should be used.

This fact pattern is similar to illustrative example 3A. In this circumstance, as the funding needs to be used for student scholarships, some stakeholders consider that the university is acting as an agent of the grantor. Under this view, the university would recognise a financial liability for the funding received.

In January 2022, the AASB issued Exposure Draft ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets arising under Concessionary Leases*, which proposed an amendment to illustrative example 3A intended to clarify the accounting requirements. However, most respondents to ED 318 were not supportive of the proposed amendments at that time, preferring that the AASB consider any changes to the example as part of this PIR.[11]

Stakeholders have suggested that to address the accounting treatment of such transactions, it is necessary first to address whether the NFP entity is considered a principal or an agent and therefore whether funds received and monies spent should be recognised on a gross or net basis.

Questions for respondents

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.

11 The main reasons given by those respondents for not proceeding with the amendments at that time were:
(a) the potential significant change in practice if the assessment of principal versus agent would result in net recognition, including the need for transitional provisions;
(b) a change in accounting treatment may reduce the size of many charities, which means that they might no longer be required to lodge any financial reports with the Australian Charities and Not-for-profits Commission (ACNC) and might no longer be subject to audit or review – implications that would need to be discussed with the ACNC;
(c) the reasons and bases for the conclusions reached have the potential for users to draw incorrect conclusions on alternative fact sets; and
(d) the scenarios illustrated in the examples in ED 318 are not practical examples. However, the complexities of more realistic scenarios that would be most beneficial to stakeholders should be addressed during the PIR.

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.

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.

Topic 5: Grants received in arrears

Current requirements

An NFP entity that receives a grant that is enforceable but that does not meet the sufficiently specific criterion accounts for the grant in accordance with AASB 1058.

Where such grants are received in arrears, NFP entities need to consider the accounting treatment of the grant. For example, should an asset representing the right to receive the asset (and associated income) be recognised:

(a) in full at the time the agreement is entered into;

(b) on a pro-rata or another basis over time as the terms of the agreement are fulfilled; or

(c) when all the eligibility criteria are met for the transaction as a whole?

Except for volunteer services, paragraph 8 of AASB 1058 requires the entity to apply the requirements of other Australian Accounting Standards (as relevant) in assessing whether an asset arising from a transaction should be recognised and how it should be measured. Under that paragraph, the entity is required to recognise, depending on the nature of the asset:

(a) a financial asset (e.g. a receivable) in accordance with AASB 9 when it has a contractual right to receive cash or another financial asset from the grantor; or

(b) another type of asset in accordance with another Standard, for example, AASB 16 *Leases*, AASB 116 or AASB 138, when the transaction gives rise to an asset that is outside the scope of AASB 9.

Feedback

Stakeholder feedback indicated there are divergent views regarding how to account for grants received in arrears, particularly where some of the work to be funded by the grant is performed before the funding is received. AASB staff released an FAQ that provides guidance and an example illustrating the accounting for a grant received in arrears.[12] However, based on stakeholders' feedback, differences in application still exists.

Example

In December 20X1, an NFP entity is awarded a funding grant in relation to community engagement. The agreement is enforceable, however, it is not considered sufficiently specific. Therefore, it is within the scope of AASB 1058.

The NFP entity is entitled to $100 per community engagement session held (without further specification in relation to the sessions, for example, location and target audience) up to a maximum of $100,000. The NFP entity submits claims for payment every six months (in July and January). Five hundred sessions have been held between January and June 20X2.

The different approaches occurring in practice are:

(a) not recognising an asset (or revenue) until the funds are received;

(b) recognising a receivable (and revenue) when the work is performed; and

12 See Section 5 in *AASB Staff FAQs: AASB 15* Revenue from Contracts with Customers, *AASB 1058* Income of Not-for-Profit Entities *and AASB 16* Leases (May 2022).

(c) recognising a contract asset as the work is performed.

The AASB considers that interpretation about the type of asset that may exist where grant funding is received in arrears depends on the facts and circumstances of the particular agreement. The AASB also notes that determining the type of asset to be recognised is outside the scope of AASB 1058 and may also be outside the scope of AASB 15.

Questions for respondents

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.

Topic 6: Termination for convenience clauses

Current requirements

A termination for convenience clause in a contract allows one or both parties to terminate the agreement without showing cause, such as default or breach of the contract. Such clauses are commonly included in government grant agreements, including but not limited to research grant agreements. For example, the grantor may, at any time, terminate the contract for the grantor’s convenience and without cause.

If a grantor were to exercise a termination for convenience clause, the grant recipient typically is liable to repay only the funds received that have not been spent in accordance with the terms of the agreement.

Feedback

Stakeholder feedback indicates that differences exist in practice as to whether a liability for unspent funds should be recognised where a termination for convenience clause exists in a grant agreement.

The two views existing in practice are that where an agreement is within the scope of AASB 1058, a financial liability should be recognised:

(a) for unspent funds when the grant is provided, with income recognised as the funds are spent; or

(b) once the clause has been exercised and there has been a request for repayment, because termination for convenience clauses are inserted only for specific purposes (e.g. a change in government). Under this approach, income is recognised on receipt of the grant, subject to the recognition of other elements per paragraph 9 of AASB 1058.

View (a)

Applying the requirements of AASB 132 *Financial Instruments: Presentation* paragraph 19, view (a) is primarily based on the fact that the receiving entity does not have an unconditional right to avoid delivering cash to settle a contractual obligation in the instance where the agreement is terminated by the grantor exercising the termination for convenience clause and demanding repayment of unspent funds. Therefore, the total amount of funding (or the amount of funding provided at inception) should be treated as a financial liability at inception by the recipient entity.

View (b)

This view is primarily based on the fact that the termination for convenience clauses are common in funding agreements with a government and are protective in nature to provide flexibility to the government where required. Therefore, accounting for these clauses should be based on the substance of the arrangement, as required by paragraph 15 of AASB 132. According to this view, the substance of most of the funding arrangements is non-financial, i.e. requiring the recipient entity to fulfil obligations under the funding arrangements rather than requiring them to repay the funds granted. Further, there is no obligation on the part of the recipient entity to repay any funds or a right for the government (or other grantor) to recover any funds until the grantor serves a written notice on the recipient. Also, until the grantor requests repayment, the recipient entity will not know what amounts will be required to be repaid to the grantor.

In addition, proponents of this view believe that there is a recognition and measurement uncertainty at contract inception because the amount that may be ultimately repaid is affected by various factors such as the timing of the notice, progress of the project, possible compensation and re-scoping of the project. Therefore, the measurement uncertainty fails the reliable measurement criterion for recognising a liability in paragraph 83 of the *Framework for the Preparation and Presentation of Financial Statements*, which is currently applicable to NFP entities.

Questions for respondents

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.

Topic 7: Accounting for research grants

Current requirements

Whether a research grant is accounted for in accordance with AASB 1058 or AASB 15 depends on the specific terms and conditions of the grant.

To determine which Standard applies, an NFP entity considers whether:

(a) it has promised to transfer goods or services (e.g. outputs from the research) to the donor or other parties on behalf of the donor; and

(b) that promise is sufficiently specific to determine when it has satisfied its obligation to transfer those goods or services.

Both factors must be present for the NFP entity to identify performance obligations in the agreement, which would mean that the agreement is within the scope of AASB 15. If one or both factors are not present, the agreement will instead be within the scope of AASB 1058.

If a research grant is accounted for in accordance with AASB 15, revenue is recognised when (or as) the entity satisfies a performance obligation by transferring the promised good or service.

In accordance with AASB 15 paragraph 35, "An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37)."

To support NFP entities in applying the requirements in paragraph 35, a range of illustrative examples were added to AASB 15 in relation to research activities.

After becoming aware of different interpretations of how AASB 15 paragraph 35(a) applies in the case of research grants and deciding that the analysis in the illustrative examples accompanying AASB 15 did not fully explain how the AASB intended paragraph 35(a) to be applied, the AASB issued AASB 2019-6 *Amendments to Australian Accounting Standards – Research Grants and Not-for-Profit Entities*.

In amending the illustrative examples attached to AASB 15, the AASB determined that paragraph 35(a) leads to three possible outcomes:

(a) if it is clear the customer (the donor) simultaneously receives and consumes the research service, paragraph 35(a) is satisfied;

(b) if it is clear the customer (donor) does not simultaneously receive and consume the research service, paragraph 35(a) is not satisfied; and

(c) if it is uncertain whether the customer (donor) simultaneously receives and consumes the research service, it is necessary to refer to paragraph B4 to determine whether paragraph 35(a) is satisfied. Paragraph B4 states that, in those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

Whilst the original conclusions in the illustrative examples were appropriate, the AASB was concerned that applying the original analysis to a different fact pattern could lead to an inappropriate application of paragraph 35(a). Accordingly, the AASB made changes to illustrative examples 4A and 4B by removing the references to re-performance and paragraph B4 in assessing the application of paragraph 35(a) and by adding an explanation in illustrative example 4B on why, in this example, it is clear that there is no simultaneous receipt and consumption by the donor of the benefits of the research entity's performance of the research activities.

The AASB noted that some stakeholders did not find the illustrative examples useful and were concerned that the fact patterns did not reflect common features of most research agreements. The AASB decided to include an additional example, illustrative example 4D, to illustrate other key contract features. This example illustrates a scenario with periodic performance obligations and was intended to assist in better demonstrating how to apply the principles in AASB 15.

The AASB has also issued *AASB Staff FAQs: AASB 15* Revenue from Contracts with Customers, *AASB 1058* Income of Not-for-Profit Entities *and AASB 16* Leases. It includes Section 2: Accounting for Research Grants, which provides further guidance on this topic.

Feedback

Although this issue has not recently been explicitly raised again, anecdotal evidence and discussions with stakeholders indicate that the issue of AASB 2019-6 has not fully resolved differences in application when accounting for research grants.

Question for respondents

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.

Topic 8: Statutory receivables

Current requirements

In accordance with AASB 9 *Financial Instruments* (paragraph C4), financial assets include contractual rights to receive cash or another financial asset from another entity. However, in an NFP context, a receivable may arise from statutory requirements rather than through a contract (e.g. rates, taxes and fines). The nature of such a receivable arising from statutory requirements is, in substance, similar to a contractual receivable, as the statutory requirements also provide an entity with a right to receive cash or another financial asset from another entity.

Accordingly, an entity recognises and measures a statutory receivable as if it were a financial asset when statutory requirements establish a right for the entity to receive cash or another financial asset. Such a right arises on the occurrence of a past event (paragraph C5).

Appendix C was added to AASB 9 to provide guidance to assist NFP entities in determining whether particular transactions or other events or components thereof are within the scope of AASB 9.

Feedback

Stakeholder feedback noted that the Appendix C requirements applying to statutory receivables apply only to the initial measurement of such assets but not their subsequent measurement. In the view of some stakeholders, this approach inappropriately permits differences across entities in the subsequent measurement of such assets.

When Appendix C was added to AASB 9, the AASB held the view that the initial fair value measurement requirements of AASB 9 are the most appropriate for statutory receivables as the economic substance of contractual receivables and receivables arising from statutory requirements is similar at initial recognition. However, the subsequent measurement of statutory receivables was not addressed at the time as the AASB decided further consideration of the matter would be needed beyond the scope of the income project. The AASB also noted that the International Public Sector Accounting Standards Board (IPSASB) had commenced a project on Public Sector Specific Financial Instruments.[13]

Feedback also suggested that the initial measurement of statutory receivables in accordance with AASB 9 added considerably to the workload of preparers and auditors.

Questions for respondents

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

13 The IPSASB initiated its Public Sector Specific Financial Instruments (PSSFI) project in 2015 to consider the appropriate accounting treatment for public sector items that are, or share characteristics of, financial instruments. The IPSASB issued a Consultation Paper in July 2016 and an Exposure Draft (ED 69) in August 2019. The final pronouncement, *Non-Authoritative Amendments to IPSAS 41* Financial Instruments, was issued in December 2020. The Basis for Conclusions noted that as statutory receivables are not contractual and do not meet the definition of a financial instrument, they would be addressed as part of a separate IPSASB project.

views on the initial measurement requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

AASB General Matters for Comment

In addition to the specific matters for comment on each topic, the AASB would also particularly value comments on the following:

22. Does the application of AASB 1058 and AASB 15 by NFP entities adversely affect any regulatory requirements for NFP entities?

23. Does the application of AASB 1058 and AASB 15 by NFP entities result in major auditing or assurance challenges?

24. Overall, do AASB 1058 and AASB 15 result in financial statements that are more useful to users of NFP entity financial statements?

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?

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?