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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
VICTORIA 8007

21 October 2016

Dear Kris,

Re: Exposure

Thank you for the opportunity to respond to the Australian Accounting Standard Board's (the AASB's) Fatal-Flaw Review Drafts – AASB 10XX *Income of Not-for-Profit Entities* & AASB 2016-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* (the Fatal-Flaw Drafts).

We support the AASB's proposed new income recognition requirements in the Fatal Flaw Drafts to replace AASB 1004 *Contributions* (AASB 1004) as we believe it will likely enhance comparability within the NFP sector given the current guidance contained within AASB 1004 based on the principle of reciprocity has resulted in diversity in practice by NFP entities.

**1. Finalisation considerations**

Whilst we are of the view that the AASB is on track in achieving its aim of issuing new income recognition requirements that better meets the needs of NFP entities and the users of their reports, we strongly recommend the AASB lengthen its standard finalisation process in refining drafting and field testing the requirements to develop a clearer output with more refined and well-articulated income recognition requirements for NFP entities.

Having regard to the potential users of the new income recognition requirements, the clarity of the requirements and the accompanying illustrative examples is extremely important as we would expect many of the NFP entities would not have the in-house technical expertise to navigate and apply the requirements if they were not clearly-articulated with clear supportive examples. In the absence of clearly-articulated and sufficiently granular accompanying examples to illustrate the application of the requirements to the various fact patterns, we are concerned that this will create significant costs for NFP entities in applying and implementing the requirements, particularly the smaller private sector NFP entities.

Given the AASB's decision to defer the effective date of the new income recognition requirements to 1 January 2019, we consider that it would be a more beneficial use of a component of the time leading up to the effective date for the AASB to refine drafting well-articulated and field-tested income recognition requirements rather than to issue the standard hastily. With well-articulated and field-tested income recognition requirements and examples issued by the AASB, these NFP entities will be better placed to avoid incurring significant implementation costs in navigating the practical application challenges.

In addition to the above, we recommend the AASB accelerate its reporting framework project as we understand that there are smaller NFP entities that are regulated and required by the ACNC to prepare general purpose financial statements, which is arguably resulting in more compliance costs than benefits of presenting useful and reliable information.

We set out our specific concerns in the sections below:

**2. Determination of 'significantly less than fair value' in paragraph 1 and Appendix D of AASB 10XX**

Paragraph 1 of AASB 10XX:

*"This Standard establishes principles for not-for-profit entities that apply to:*

*(a) transactions where the consideration to acquire an asset is* ***significantly less than*** *[emphasis added] fair value principally to enable a not-for-profit entity to further its objectives; and*

*(b) the receipt of volunteer services."*

Per paragraph 1 of AASB 10XX (extract above), the objective of AASB 10XX is to capture 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 objectives and the receipt of volunteer services. We note that there is currently a lack of guidance in the Fatal Flaw Drafts to assist entities in determining what difference between the consideration provided to acquire an asset and the fair value of the asset would be considered sufficient to be deemed as 'significantly' less than fair value.

While the assessment may be straightforward in cases where the NFP entity has acquired an asset for no consideration (as detailed in Illustrative Examples 2 and 3 in AASB 10XX), there will be many cases in the NFP sector where NFP entities would have provided some consideration to obtain the asset (which may or may not be relatively similar in value to the asset's fair value) and the NFP entities may therefore have difficulty in assessing whether the consideration provided is 'significantly' less than the asset's fair value.

In Illustrative Example 1 in AASB 10XX, the fact pattern states that the consideration paid for the printers (at a price that includes a trade discount available to all bulk purchasers) is considered to be significantly less than the printer's fair value. We are concerned that with the lack of guidance, this example seems to imply that the quantity of a bulk purchase trade discount is considered sufficient to meet the 'significant' requirement.

Furthermore, we note that this criteria of the consideration being 'significantly' less than fair value is also present in Appendix D of AASB 10XX, specifically in the asset fair value measurement requirements in the amendments to AASB 102, AASB 128, AASB 138, AASB 140 and the guidance on leases at 'significantly' below-market terms and conditions in the amendments to AASB 117 and AASB 16.

While we acknowledge that the concept of 'significant' is present in the current Australian Accounting Standards (e.g. the concept of 'significant' reversal on variable consideration in AASB 15), we recommend the AASB consider including application guidance to assist entities in interpreting the concept of 'significant'. As detailed above, many of the NFP entities would not have the in-house technical expertise to navigate and apply the requirements and additional guidance would be imperative in ensuring that the concept is applied correctly and consistently across the sector.

**3. Clarity of the wording on the Illustrative Examples accompanying AASB 10XX**

We note that the clarity of the wording of the Illustrative Examples accompanying AASB 10XX could be improved, specifically the explanation surrounding the evaluation of the facts in determining the appropriate accounting treatment under AASB 10XX and in some cases the application thereof.

As detailed above, the clarity of the requirements and the accompanying illustrative examples is extremely important as we would expect many of the NFP entities would not have the in-house technical expertise to navigate and apply the requirements if they were not well-articulated with clear supportive examples.

We recommend the AASB conduct a close review of the wording in the Illustrative Examples in providing a well-articulated basis for the appropriate accounting treatment under AASB 10XX to ensure that the NFP entities are able to apply and implement the new income recognition requirements as the AASB intended and on a consistent basis.

Referring back to the AASB Action Alert for the 21-22 June 2016 Board meeting, specifically the discussion under the sub-heading of 'Perpetual endowments' in the 'Income of NFP Entities' section, we note that the current guidance on the Fatal Flaw Drafts does not contain the examples and guidance proposed by the AASB's tentative decisions made on the various matters discussed at that meeting.

By way of illustration, we highlight below two of the examples (we note that all other examples should also be reviewed consistent with the above comments and those under 1 and 2 above):

*Example 4—Endowment made to a university*

a) The asset and investment income

In Example 4B, the current wording detailing the evaluation of the fact pattern could be improved to clearly articulate the reasoning behind the appropriate accounting treatment. The explanation states that there is no provision of service or a specific good as the entire income generated from the principal amount must be applied towards funding one or more cash scholarships. It appears that the example is highlighting that the University may have no rights to the asset and future income streams as the students who receive scholarships will receive all income and will only direct some or all of that amount to the University at their discretion. However, this is implied rather than being stated. Some readers may confuse this aspect with tuition scholarships which would result in the provision of services.

b) Application of AASB 9

We also note that the accounting treatment suggests that University A should assess if de-recognition of the principal amount is required under AASB 9, which raises the question as to why University A would have recognised a financial asset for the principal amount in the first instance; as opposed to recognising and subsequently de-recognising the asset. We believe the explanation should be expanded to discuss University A's assessment of control over the principal amount as compared to the control over the right to the investment income.

Given the nature of the users, being NFP entities, we consider it appropriate for the AASB to address the application of AASB 9 with sufficient guidance provided on the recognition and measurement of financial assets and financial liabilities.

*Example 1—Goods purchased with a trade discount or in a distress sale*

Extract of Example 1:

*"Entity A makes the following purchases:*

- *printers, from Seller A, at a price that included a trade discount available to all bulk purchasers; and*
- *computers, as part of a liquidation sale from Seller B, at the same price available to the public – the sale price is significantly below the fair value of the computers."*

In Example 1, the current wording (see extract above) detailing the background fact pattern could be improved as it is currently unclear if Entity had in fact made a bulk purchase of printers which therefore

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entitled it to the trade discount, or whether Entity A did not made a bulk purchase but was still provided with the trade discount – for example, an entity would usually be required to made a bulk purchase of 20 printers to be entitled to a trade discount but in this case, it is not clear whether Entity A qualified for and therefore was still offered the trade discount.

While it is clear in the former case that the trade discount was offered to Entity A on the basis of a bulk purchase and this would therefore not be considered a factor that the trade discount was provided to Entity A principally to enable it to further its objectives. In the latter case, the trade discount provided to Entity A despite it not being entitled to it as it did not made a bulk purchase, could arguably be considered a factor that the trade discount was provided to Entity A principally to enable it to further its objectives.

We suggest that the AASB clarify the background fact pattern to remove any confusion and to ensure that the NFP entities will be able to apply the requirements correctly and consistently across the sector. Our suggested wording is displayed below:

*'Entity A makes the following purchases:*

- *printers, from Seller A, at a quantity that entitled it to a price that included a trade discount available to all bulk purchasers; …..'*

If you have any questions concerning our comments, please contact me at 03 9671 7553 or Maybelle Chia at 03 9671 7071.

Yours sincerely

**Clive Mottershead**
Partner
Deloitte Touche Tohmatsu