

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

24 September 2015

Dear Kris

## **Re: Exposure Draft ED 260 – Income of Not-for-Profit Entities**

Thank you for the opportunity to respond to the Australian Accounting Standard Board's (the AASB's) Exposure Draft ED 260 – Income of Not-for-Profit Entities (the Exposure Draft or the [draft] Standard).

We support the AASB's proposal to replace AASB 1004 *Contributions* (AASB 1004) as we believe the guidance that is contained within AASB 1004 outlining the principle of reciprocity in the recognition of income is flawed. In many instances the existence of "reciprocity" for a not-for-profit (NFP) entity is indirect, i.e. the entity or individual providing the funds are often not the beneficiary to the services that the NFP entity provides. However this does not undermine the fact that in many circumstances the NFP entity is obligated to provide goods/services. We believe that in these circumstances the income recognition for a NFP entity should not be any different to how a for-profit entity accounts for the transaction. In this regard, we support the key principle laid out in the Exposure Draft that a NFP entity should recognise income when it has completed its performance obligation applying the concepts in AASB 15 *Revenue from Contracts with Customers* (AASB 15).

However our concern is that the Exposure Draft inadvertently introduces guidance that is unduly complex, is likely to require significant investment of skills and resources by many NFP organisations in order to understand and interpret the guidance, and is unlikely to produce financial information that is "more" meaningful for users of financial statements of smaller private NFP entities, in particular. We are particularly concerned about the criteria laid out in the Exposure Draft, being the existence of an "enforceable agreement to make a sufficiently specific transfer of goods/services", for application of AASB 15 by a NFP entity. The assessment of whether the grantor has a right to enforce the agreement through "legal *or equivalent* means" [emphasis added] and whether the agreement contain "sufficiently specific obligations" will create significant difficulty to NFP entities, which we have discussed in details in Question 1 and 2 in the Appendix to this letter.

For any accounting standard to be implemented the usefulness and reliability of information presented for the users to understand the accounting should justify the costs associated with implementation and ongoing compliance. We are concerned as to whether some of the concepts included in this Exposure Draft will provide meaningful, relevant and reliable information to the users, eg. measuring and reporting of voluntary services, measuring of goods donated to a NFP entity as inventory and tracking the inventory balance, splitting of donation amounts into that for goods/services, etc.

We consider that extending the requirements to include income recognition and measurement criteria to volunteer services received by NFP entities, whether mandatory or as an accounting policy choice, will result in significantly more cost than benefit as this will create an additional administrative burden on what are already resource-constrained entities seeking volunteer services from the Australian community.

Additionally, we believe that the structure of the [draft] Standard should be reconsidered such that all guidance related to the NFP entities is included in one single Standard. Hence we suggest that Appendix E of the Exposure Draft is included as part of AASB 10XX rather than adding it as an appendix to AASB 15.

Finally we recommend that the AASB consider the separation of the [draft] Standard into two separate standards, or excluding public sector NFP entities from application of the standard. If public sector NFP entities are seeking NFP guidance from Australian Accounting Standards we recommend the implementation of a standard or guidance for application by public sector NFP entities which should be developed with adequate consultation with the Commonwealth Department of Finance and the respective Australian State Treasury Departments, such that each of the treasury departments do not need to publish additional guidance for their respective jurisdictions. We understand that there may be a need and a preference amongst the Government NFP entities to claim compliance with International Financial Reporting Standards (IFRS) which will not be achieved if they have to comply with NFP guidance. A separate standard appropriate for private sector NFP entities can be developed which will address their relevant issues. We believe that the challenges and constraints faced by each group are sufficiently different such that a “one size fits all” approach to developing accounting standards and principles of recognition and measurement for NFP entities is not an optimal result.

We have provided our responses to the specific matters for comment which are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact me at 02 6263 7044 or Indrani Pal at 02 9322 5103.

Yours sincerely

Alexandra Spark  
Partner  
Deloitte Touche Tohmatsu

## Appendix: Specific and general matters for comment

### **Question 1: Whether income recognition requirements based on satisfying a performance obligation provide a more faithful depiction of a not-for-profit entity's financial performance than the reciprocal/non-reciprocal transfer distinction in AASB 1004?**

We support the AASB's proposal to replace the current revenue recognition model based on whether the transfer is reciprocal or non-reciprocal in accordance with AASB 1004. We believe that income recognition following the satisfaction of a performance obligation is conceptually a better principle. There should not be any difference in the timing of revenue recognition for transactions which in substance are identical, irrespective of the transaction being undertaken by a for-profit or a NFP entity. Aligning to the principles laid out in AASB 15 *Revenue from Contracts with Customers* (AASB 15) will assist in enhancing the AASB's objective of maintaining transaction neutrality in the standard-setting process.

However we are concerned about the interpretation and practical application of the step "*whether an enforceable agreement to make a sufficiently specific transfer of goods/services exists*" in the process of identifying the appropriate timing of revenue recognition.

#### ***Private sector:***

Private sector NFP entities often have relatively simple funding agreements with their donors and/ or grantors where the focus of the entity and the users of financial information produced by the NFP entity is on whether the NFP entity has continued to and is able to continue to meet their benevolent objective. The enforceability of each individual donation or grant or funding arrangement is often not considered and there is no explicit reference to refunding the grant amounts if the stated conditions are not met.

#### ***Public sector:***

A public sector NFP entity, on the other hand, may often have a 'refundable' clause in their grant/funding agreements if certain conditions are not met. The strict enforceability of this clause however varies within the Government departments and agencies.

Hence there can be scenarios where although an "*enforceable agreement*" does not exist, a NFP entity is still required to perform under the arrangement, i.e. undertake certain activities, thus creating 'performance obligations'. In such cases, it is not incorrect to apply the revenue recognition model of AASB 15, where the timing of revenue recognition follows satisfaction of performance obligation. However, the guidance of this [draft] Standard would result in revenue being recognised too soon due to the 'lack of enforceability' within the agreement.

In reality, the key driver for the NFP entity to use the funds for the stated objective is the risk of losing future funding amounts and reputational damage. The NFP entity would view this as having a constructive obligation as described in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* (AASB 137). We request the AASB to provide additional guidance, perhaps with reference to AASB 137, in what should be considered as "equivalent to legal enforceability".

### **Question 2: Does a promise need to be 'sufficiently specific' to qualify as a performance obligation?**

We agree that conceptually a performance obligation should be sufficiently specific such that a NFP entity could assess the timing for satisfaction of these performance obligations for revenue recognition purposes. However we request the AASB to add further clarity as to when an obligation is considered to be "sufficiently specific".

We believe that the concept of assessing whether a sufficiently specific performance obligation exists before a NFP entity could recognise revenue should be applied by the entity with regards to the objectives and purpose set out for the particular NFP entity. This needs to be aligned to its charter and the projects for which it seeks funding from the public.

As an example, an entity offering various services to the disadvantaged communities across the world may consider “offering relief to the flood affected areas in Bangladesh” to be sufficiently specific while another entity operating solely to provide relief to natural calamity victims in Bangladesh may not consider this to be meeting the criteria of “sufficiently specific” as contemplated in the [draft] Standard. Similarly for an organisation “focussing on improving the health of disadvantaged communities” may face challenges in determining whether “arranging for health check-ups” will be considered specific or whether the agreement to receive funds needs to contain clauses like “arranging ten health check-up camps during the month of October 2015” to be considered sufficiently specific.

### **Question 3: Whether the recognition criteria of a donation component are appropriate?**

We agree in principle with the proposals in the Exposure Draft. However the requirement to split the donation component from other goods and services based on ‘separately identifiable’ criteria can pose significant challenges for practical application, the cost of which may outweigh the benefits of compliance with the [draft] Standard. It will often be difficult to assess the mindset of a donor as to whether the amount paid was for goods/services or genuinely in the nature of a donation with no expectation to receive any further benefits from the NFP entity or requiring the NFP entity to provide any specific ongoing benefits to others.

We urge the AASB to consider the feedback it receives from the outreach performed at private NFP entities and the Australian Charities and Not-for-profits Commission (ACNC) who may find this requirement burdensome.

Furthermore paragraph IG28 of Appendix E provides exemption from assessing the materiality of the donation component on an aggregate basis if it is not considered material at an individual contract level. We believe that the AASB does not need to comment on materiality specifically in this [draft] Standard; rather the guidance relating to portfolio approach contained within paragraph 4 of AASB 15 can be referred to.

### **Question 4: Whether the proposals related to recognition and measurement of volunteer services by the NFP entities appropriate?**

We do not support the concept of measuring voluntary services and reporting the same on the financial statements for both private and public sector NFP entities. We do not believe that recognition of voluntary services as income will provide any meaningful or comparable information to the users since the basis for measurement will be widely varied. As an example, the time required to perform certain tasks by a skilled employee / service provider may differ considerably to that needed by a volunteer and also the relative cost per hour and quality of output could differ significantly. In such circumstances the application of significant judgement to estimate the value of the voluntary services received will be required and notwithstanding assessment may not derive an objective outcome. This is akin to establishing a “WORK Measurement” in the manufacturing industry context, where various techniques are applied to establish the time for an average worker to carry out a specific manufacturing task at a defined level of performance and is concerned with the length of time it takes to complete a work task assigned to a specific job. It will be incredibly complex for a NFP entity to establish such a measure and an appropriate imputed rate of pay. Even when determined it will often not be consistently determined information across NFP entities. Volunteer services often are provided to those organisations which lack resources. Accordingly additional reporting requirements will only add to the administrative burden and costs for these NFP entities without any substantial benefits.

Furthermore we believe that including accounting policy choices currently proposed in the Exposure Draft, i.e. public and private NFP entities can elect to recognise the voluntary services if they are reliably measurable, will only add to the divergence and reduce the comparability of the financial statements amongst the NFP entities as there will be a number of entities who will choose not to recognise the voluntary services. We suggest that the AASB remove these requirements from the [draft] Standard.

For any voluntary services that are received by public sector entities which are for-profit, as contemplated in paragraph 19 of the Exposure Draft, we do not believe that such guidance should be included in this [draft] Standard. We further believe that volunteer services could be viewed as inputs to delivering the core objectives of a NFP entity and could be reported as a service performance metric rather than measuring the same and reporting as a financial metric within the financial statements of the NFP entity.

**Question 5: Should materiality for inventories that are donated to a NFP entity be assessed at an individual transaction basis without reassessment at a portfolio or other aggregate level?**

We have been informed that there is divergence in current practice in the private sector NFP entities, where either the NFP entity does not record any income with corresponding inventory or may have an accounting policy of either valuing donated items individually or on a per unit of weight basis.

We do not believe that mandating income recognition with corresponding inventory at an individual transaction level or at an aggregate level will add significant benefits for a private sector NFP entity. The true performance metrics should be linked to how much of income the NFP entity can make by selling the donated goods rather than establishing the value of the inventory when the donation is received. The model of recognition of inventory, cost of goods sold and revenue will add significant costs of compliance for a NFP entity without providing any additional meaningful information.

We further believe that conceptually the requirement to apply the [draft] Standard at individual transaction level or on aggregated transaction basis should not be any different to the application of the portfolio approach contemplated in paragraph 4 of AASB 15. Accordingly, we do not consider there is any necessity for the AASB to include paragraph 31 of the [draft] Standard specifically to address the application of materiality concept and determine the unit of account.

**Question 6: Is there a necessity to provide definition of ‘contributions by owners’ in Australian Accounting Standards and if so, which definition is preferred?**

We do not consider it necessary to have the definition of ‘contributions by owners’.

We prefer principles based standard setting and to the extent possible limit the existence of Australian-specific standards, interpretations and other guidance. The for-profit entities applying Australian Accounting Standards consider the substance of each transaction to determine if it is an equity transaction and we believe that the same could be followed by the NFP entities which will do away with the necessity to have definition of ‘contributions by owners’ specific only to NFP entities.

**Question 7: Specific matters related to ‘contributions by owners’**

We would support a removal of AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* for reasons stated above in Question 6.

We believe that all entities, regardless of being in private or public sector, should be able to apply the concepts contained within the Australian Accounting Standards to determine whether a transaction is equity in nature. Similarly determining whether a transaction is in the nature of ‘distribution to owners’ should also

be based on concepts existing within the Australian Accounting Standards and do not require any additional guidance.

There is a possibility that the Commonwealth Department of Finance and the respective Australian State Treasury Departments may look for additional guidance with respect to ‘contributions and distributions from/to owners’ and ‘restructures of administrative arrangements’ which if absent may trigger issuance of state level guidance. We suggest that the AASB work closely with the Commonwealth and State Treasury Departments to ensure there is no perceived gap in guidance and that the application of existing guidance within the Australian Accounting Standards is acceptable.

**Question 8: Whether the disclosure requirements regarding compliance by government departments with appropriations proposed in the Exposure Draft considered appropriate?**

We agree with the proposal and note that this supports the concept of transaction neutrality.

**Question 9: Whether the transitional provisions proposed in the Exposure Draft considered appropriate?**

We agree with the transitional provisions. However we believe that the AASB should consider incorporating some relief from the requirements to restate the non-financial assets and finance lease assets and liabilities which were not recognised initially at fair value as the costs to calculate this information may outweigh its benefits for some entities.

**Question 10: Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?**

We are not aware of any regulatory issues but believe that the benefits to the users from the application of the [draft] Standard will not be adequate to justify the costs of compliance with this [draft] Standard, especially for private NFP entities.

**Question 11: Whether, overall, the proposals would result in financial statements that would be useful to users?**

A number of the proposals in this [draft] Standard are more likely to be relevant and address the concerns of public sector NFP entities thus assisting in providing meaningful and useful information, especially where the public sector entities have expressed their intention of being able to state “IFRS compliance” in their financial statements, albeit our responses to Question 3 and 4 raising concerns about recognition and measurement of donations and volunteer services are relevant to public sector NFP entities as well.

Moreover we have been provided with views and concerns that the application of the guidance contained in this [draft] Standard together with AASB 15 can increase the costs of compliance significantly, especially for private sector NFP entities, thus placing a strain on resources available for their core objectives. As discussed above in Questions 3, 4 and 5, we do not believe that the guidance included in this [draft] Standard will provide meaningful reliable and comparable information to the users of the financial statements.

Hence we urge the AASB to consider the outreach and comments received from the Australian Charities and Not-for-profits Commission (ACNC) and any private NFP entities to ensure that the ongoing costs of application of this [draft] Standard do not outweigh the benefits.

**Question 12: Whether the proposals are in the best interests of the Australian economy?**

As stated above in Question 11.

## Question 13: Other comments

Our view is that a user should be able to start the assessment of whether to apply the guidance contained in this draft [Standard] or to apply AASB 15 from the scope section of this [draft] Standard. This scope assessment is based on “*whether an enforceable agreement to make a sufficiently specific transfer of goods/services exists*” and all the guidance contained in Appendix E is currently proposed to be added as an appendix to AASB 15. We believe it will be inefficient and confusing for a user to read an appendix of AASB 15 first before applying this [draft] Standard. Hence we suggest that the [draft] Standard incorporates all relevant guidance relating to the income recognition of NFP entities rather than including some sections as part of an appendix to AASB 15.

We also recommend that the AASB consider two separate Standards – one for the public sector NFP entities and the other for private sector NFP entities as the challenges and constraints faced by each group are different and a common Accounting Standard will not achieve an optimal result for recognition and measurement of income by the two different groups of NFP entities.

Yours sincerely



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