



Level 13, 664 Collins Street
Docklands, VIC 3008

Level 1, 80 Monash Drive
Dandenong South, VIC 3175

Postal address
GPO Box 5193
Melbourne, VIC 3001

p. +61 3 8610 5000

1 March 2023

Dr. Keith Kendall
Chair
Australian Accounting Standards Board
Level 14, 530 Collins Street
Melbourne VIC 3000

Via email: standard@aasb.gov.au

Dear Dr. Kendall

SUBMISSION – POST-IMPLEMENTATION REVIEW – INCOME OF NOT-FOR-PROFIT ENTITIES

We appreciate the opportunity to provide comment to the Australian Accounting Standards Board (the AASB) on the AASB's *Post-implementation Review – Income of Not-for-Profit Entities* (the Review).

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Firms in the Pitcher Partners network are full service firms and we are committed to high ethical standards across all areas of our practice. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, not-for-profit entities and small to medium sized enterprises.

We consider that the standards AASB 15 and AASB 1058 as applicable to not-for-profit entities (NFPs) is confusing for NFP preparers and practitioners, it is open to significant judgement and as a result comparability is lacking between NFP entities. Further, the specific NFP requirements seems to be over and above that required for for-profit entities.

Whilst the FAQ document developed by AASB staff was a good attempt to assist and educate the sector, we do not consider in the long-term separate FAQ documents to be helpful, as they are difficult to locate. We consider that examples should be part of the guidance within the relevant standard.

However, it is also important to consider that NFPs have interpreted the requirements to the best of their ability (albeit with inconsistent outcomes) and would not want to see substantial changes made to the standards that would make it even more difficult to apply the standards and require more guidance and more examples.

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Internationally an initiative, called IFR4NPO, is underway to develop the world's first internationally applicable financial reporting guidance for non-profit organisations (NPO) to improve clarity and consistency of NPO financial reports. The initiative is being championed by a partnership between Humentum and the Chartered Institute of Public Finance and Accountancy in the UK and involves standard setters across the world. This initiative has currently produced its first of three exposure drafts with a timeline for completion in 2025. This initiative will include the development of a conceptual framework for NFPs (included in Exposure Draft 1) and we encourage the AASB to contribute to this initiative as it progresses.

We consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

We include our detailed comments to the majority of questions posed in the attached Appendix.

Please contact Ms Kerry Hicks, Director – Technical Standards (02 9228 2272 or kerry.hicks@pitcher.com.au), in relation to any of the matters outlined in this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'K L Byrne'.

K L Byrne
Partner

A handwritten signature in black ink, appearing to read 'Kerry Hicks'.

Kerry Hicks
Director, Technical Standard

APPENDIX: SPECIFIC MATTERS FOR COMMENT
Topic 1: Sufficiently specific criterion and the legal interpretation of agreements

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.

Response:

The term 'sufficiently specific' is confusing for NFP preparers and practitioners, it is open to significant judgement and as a result comparability is lacking between NFP entities. Further, this requirement seems to be over and above that required for for-profit entities where the term 'sufficiently specific' does not exist.

Page 9 of the PIR provides examples (a) to (h) along with a conclusion and analysis. The analysis provided on some of the conclusions seems to indicate that all the factors in AASB 15 paragraph F20 are required for the item to be sufficiently specific. However, paragraph F22 states that '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.' Our view is that without at least the majority of these factors present in a contract (if not all the factors), it will not meet the sufficiently specific criteria.

Our comments on the scenarios provided on pages 9 and 10 differ to that outlined in the PIR and are as follows:

- Scenario (c) – our interpretation is that it is not 'unclear' as stated in the conclusion, but the conclusion should indicate it is not sufficiently specific as there is no detail indicating the quantity of the services to be provided.
- Scenario (d) – our interpretation is that it is not sufficiently specific rather than the conclusion stated that it 'May be sufficient specific'. This is because the quantum of counselling services is not stated in the contract.
- Scenario (e) – similar comments to that on scenario (d) above
- Scenario (f) – our interpretation is that this is not sufficiently specific since it does not contain any quantity in the fact pattern, only the type of goods or services and the period over which they are delivered.
- Scenario (g) – similar comments to that on scenario (f) above.

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The differences in our comments compared to that outlined in the PIR reveal the significant judgement involved with such a determination and therefore in our view this distinction is not effective and needs significant revision. However, it is also important to consider that entities have interpreted the requirements to the best of their ability (albeit with inconsistent outcomes) and would not want to see substantial changes made that would make it even more difficult to apply the standards.

We do not believe that adding more examples or more guidance to explain the current requirements would be useful. As it is, with two standards to navigate, as well as an FAQ document NFPs and practitioners find it confusing as to where to locate the relevant guidance and to understand the interaction between the two different standards. As a short-term measure, we recommend the AASB remove the FAQ document and locate any examples as part of the guidance in the relevant standard.

Rather than wholesale changes to the standards as a result of this PIR, we consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

Topic 2: Capital grants
<p>Regarding the term identified specifications in AASB 1058 paragraph 15(a), do you have any comments about:</p> <p>5. the application of the term in practice?</p> <p>6. the extent of specificity needed for a contract to meet the requirements of AASB 1058 paragraph 15(a)?</p> <p>7. whether differences in application exist because of the use of the term identified specifications?</p> <p>If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.</p> <p>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.</p>

Response:

The term 'identified specifications' is confusing for NFP preparers and practitioners, it is open to significant judgement and as a result comparability is lacking between NFP entities. Further, this requirement seems to be over and above that required for for-profit entities where the term 'identified specifications' does not exist.

Page 11 of the PIR provides examples (a) to (g) along with a conclusion and analysis. Our comments on the scenarios provided differ to that outlined in the PIR as follows:

- Scenario (c) – our interpretation is that this would meet 'identified specifications' since it is to be constructed to a standard specified by government regulations applicable to the EL programs.
- Scenario (d) – similar to above, this differs to the PIR conclusion of 'Unclear'.

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- Scenario (e) – our interpretation is that this would not meet ‘identified specifications’ rather than ‘Unclear’ as indicated by the PIR since there is no detail on the type/size of the building to be constructed.

The differences in our comments compared to that outlined in the PIR reveal the significant judgement involved with such a determination and therefore in our view this distinction is not effective and needs significant revision. However, it is also important to consider that entities have interpreted the requirements to the best of their ability (albeit with inconsistent outcomes) and would not want to see substantial changes made that would make it even more difficult to apply the standards.

As previously explained, we do not believe that adding more examples or more guidance to explain the current requirements would be useful. As a short-term measure, we recommend the AASB remove the FAQ document and locate any examples as part of the guidance in the relevant standard.

Rather than wholesale changes to the standards as a result of this PIR, we consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

Topic 3: Differences between management accounts and statutory accounts and alternative revenue recognition models
<p>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.</p> <p>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:</p> <p>(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;</p> <p>(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;</p> <p>(c) on a systematic basis over the periods in which the entity recognises as expenses the related costs for which a grant is intended to compensate; or</p> <p>(d) where the outflows of resources are incurred in accordance with the requirements set out in a binding agreement.</p> <p>If so, please provide your views on your preferred alternative(s) above or another alternative approach.</p>

Response:

The confusion in navigating AASB 15 and AASB 1058, with both giving different outcomes on the timing of revenue recognition, has resulted in frustration and significant cost involved amongst NFPs and practitioners in applying the requirements. Further, AASB 15 and AASB 1058 has not addressed the lack of comparability issue that existed under the previous accounting standards.

If any alternative approach is selected to replace AASB 1058, there would still be a need for a clear distinction between AASB 15 and any alternative selected to replace AASB 1058. If such

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a distinction cannot be made clear, then we would support creating one combined standard for NFP revenue/income.

Of the options provided above, our preference is either option (c) (which is consistent with AASB 120) or option (d) (which is consistent with an Exposure Draft issued in 2020 by the International Public Sector Standards Board relating to Revenue without Performance Obligations). Option (b) seems reasonably consistent with option (d).

Option (a) which is based on a 'common understanding' does not, in our view, meet the definition of a liability. For example, if donors donated funds and there was a common understanding the funds were to be used for a recent flood appeal – option (a) would present this as a liability on receipt. We would not consider that such 'common understanding' would be sufficient to meet the definition of a liability especially when the funds could in fact be used for any purpose determined by the NFP, even though the understood purpose may be in relation to the flood appeal.

Rather than wholesale changes to the standards as a result of this PIR, we consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

Topic 4: Principal v agent, including the appropriate recognition of financial liabilities
<p>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:</p> <p>11. the determination of whether the entity is a principal or an agent?</p> <p>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?</p> <p>If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.</p>

Response:

The concept of principal versus agent is a difficult concept to apply, even in the for-profit sector and is subject to considerable judgement. The examples and guidance provided within AASB 15 in relation to this topic were developed internationally and were not drafted with the NFP sector in mind.

Therefore, we consider it is important for the AASB to provide additional guidance in Appendix F on the application of the principal versus agent requirements to the NFP sector.

To the extent that funds are received by a NFP, as a pass-through arrangement, under a contractual agreement where the NFP has no ability to access those funds to further its objectives or decision-making ability in relation to those funds, in our view, a NFP may be considered an agent.

As an example, a large NFP received monies from the government on behalf of a number of other smaller NFPs. The government agreement (or the application forms received that form part of the agreement) clearly indicates which amount each smaller NFP was to receive and exactly what the funds are to be used for. The government only deals with the large NFP from

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an efficiency perspective, so they do not have to deal with a large number of smaller NFPs (all with similar objectives). The larger NFP does not have any decision-making ability in relation to the funds received and merely acts as an agent in relation to funds received from the government. It does not record income in respect of the funds and immediately recognises the funds received as a liability until the amounts are paid over to the smaller NFPs.

Topic 5: Grants received in arrears

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.**

Response:

We have no comment on this as we have not encountered this issue with our clients.

Topic 6: Termination for convenience clauses

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.**

Response:

We support view (a) – that where a termination for convenience clause exists in a funding agreement which has substance, a financial liability should be recognised for unspent funds when the grant is provided, with income recognised as the funds are spent. This recognises the stand ready obligation that the entity has to return the funds at the request of the funding provider under the terms of the agreement. In order to do this, the agreement should also contain a clause requiring the repayment of monies at the time of the termination for convenience.

We consider the AASB should issue guidance in this area to clarifying the appropriate accounting as we understand that inconsistency exists in relation to this matter. The guidance should also address the subsequent accounting, as the funds are spent and the liability is reduced, and whether the classification of the resulting profit or loss item.

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Topic 7: Accounting for research grants

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.

Response:

Our comments on accounting for research grants are broadly in line with our comments on the terminology 'sufficiently specific' and the problems with drawing the line between AASB 15 and AASB 1058. However, it is also important to consider that entities have interpreted the requirements to the best of their ability (albeit with inconsistent outcomes) and would not want to see substantial changes made that would make it even more difficult to apply the standards.

As previously explained, we do not believe that adding more examples or more guidance to explain the current requirements would be useful. As a short-term measure, we recommend the AASB remove the FAQ document and locate any examples as part of the guidance in the relevant standard.

Rather than wholesale changes to the standards as a result of this PIR, we consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

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General matters for comment
<p>In addition to the specific matters for comment on each topic, the AASB would also particularly value comments on the following:</p> <p>22. Does the application of AASB 1058 and AASB 15 by NFP entities adversely affect any regulatory requirements for NFP entities?</p> <p>23. Does the application of AASB 1058 and AASB 15 by NFP entities result in major auditing or assurance challenges?</p> <p>24. Overall, do AASB 1058 and AASB 15 result in financial statements that are more useful to users of NFP entity financial statements?</p> <p>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?</p> <p>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?</p>

Response:

The application of AASB 1058 and AASB 15 requires the use of significant judgement which can impose major auditing or assurance challenges – especially in circumstances where the NFP entities do not have the skills and resources to make and document such judgements with supporting analysis.

The usefulness of AASB 1058 and AASB 15 is debateable, given the cost it takes to apply the standard and the inconsistencies that result as mentioned in the previous questions. In our view, the cost of applying AASB 1058 and AASB 15 have far exceeded any benefits in its application. Further, ongoing complexity exists in relation to new agreements entered into by NFPs on a regular basis. Little benefit has been achieved, over and above the previous accounting standards, in respect of consistency and comparability of information.

Rather than wholesale changes to the standards as a result of this PIR, we consider that once the IFR4NPO standard has been finalised, the AASB explores the appropriateness of its adoption in full or in part in Australia for all NFP entities, including those applying Tier 1 and Tier 2 Australian Accounting Standards.

