



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

14 August 2015

Dear Kris

Invitation to Comment on ED 260 *Income of Not-for-Profit Entities*

We are responding to your invitation to comment on the above Exposure Draft (ED).

We support the Board's proposals to update the accounting requirements for income recognition for not-for-profit entities. With the introduction of AASB 15 *Revenue from Contracts with Customers* (AASB 15) in the for-profit sector, we agree it is appropriate to better align not-for-profit entities to the principles of that standard. We also agree AASB 1004 *Contributions* (AASB 1004) could be improved. Many entities find the current accounting requirements challenging to interpret and apply which leads to diversity in practice. While the proposals in the ED should address some of these challenges, we acknowledge that they could introduce new complexities and costs for smaller private not-for-profit entities which the AASB should consider.

We have identified some areas where additional guidance, clarifications or examples would be useful, most notably the application of the concept of an enforceable agreement. These areas are highlighted in our responses to the specific matters for comment included in Appendix A.

In our view, the proposals in the ED and the resulting standards should only be applicable for not-for-profit entities, whether public sector or private. Any guidance in relation to the for-profit public sector that is retained in Australian Accounting Standards should be located elsewhere.

In relation to contributions from owners, our preferred view is to keep a principles-based definition (with examples) for not-for profit entities within the proposed standard, AASB 10XX. The guidance in this area is relevant and well used in the public not-for-profit sector, where non-arms-length transactions are commonplace. If a principles-based definition is not included, our view is that the current guidance should be removed to allow for application based on substance.

Our detailed responses to the specific matters for comment are provided in Appendix A. We have also provided the AASB staff an annotated copy of the ED with less significant comments on wording and consistency matters separately to this response.

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I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (02) 8266 2845.

Yours sincerely

A handwritten signature in black ink that reads "Erin Craike". The signature is written in a cursive style with a large, prominent initial "E".

Erin Craike
Partner, PricewaterhouseCoopers



Appendix A: Detailed responses to ED 260

1. Do you agree that 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 Board's approach of better aligning income recognition requirements of not-for-profit entities to the principles in AASB 15. This allows revenue to be recognised as and when obligations are satisfied. The current reciprocal/non-reciprocal transfer distinction under AASB 1004 is difficult to apply and interpreted inconsistently in practice. The proposed changes should improve comparability and consistency in application.

While we support the Board's direction, there are still areas of uncertainty that the Board should address. Specifically, the application of the concept of an "enforceable agreement" is unclear and whether that is the appropriate threshold for not-for-profit entities. The guidance in paragraph IG4 states that enforceability is by 'legal or equivalent means'. We understand in many cases, larger corporate donations may be received by not-for-profit entities with a detailed memo of understanding (MOU). This MOU would specify how the entity should use the funds. However, it is unlikely the grantor would be able to either enforce the specific performance or the payment of a refund/penalty. The Board should consider providing examples of enforceability by 'equivalent means' and perhaps clarify through an example whether a written memorandum of understanding could be deemed to be enforceable when it is not legally enforceable.

We also recommend that the Board consider whether the definition of constructive obligations in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* may be relevant to determine whether an entity has an agreement for the purposes of applying AASB 15. A constructive obligation arises where an entity indicates it will accept certain responsibilities which lead to a valid expectation that it will discharge these responsibilities. The nature of an arrangement between a grantor and a not-for-profit entity may be sufficiently different than an arrangement between a for-profit entity and its customer such that a broader definition of enforceability may be more appropriate. Many not-for-profit entities agree to perform certain specific obligations which are not legally enforceable but due to moral obligation and past practice, the grantor expects the entity to fulfil its promise. The not-for-profit entity may also consistently demonstrate that it does fulfil its promise. The current proposed requirements may not result in the appropriate accounting in these types of situations.

2. To qualify as a performance obligation, does a promise need to be 'sufficiently specific'?

We agree with the Board that a performance obligation should be 'sufficiently specific', however we recommend that Example 3 in the Illustrative Examples be considered to ensure that these criteria are applied based on the substance of the promise.

Specifically, the examples should be clear that two entities with significantly different charters should recognise income for a similar grant in a similar manner, based on substance. For example, one charity may have a very narrow charter where it only provides counselling services. If this charity receives a grant for SX to spend over a one year period in accordance with its charter, it may conclude that the grant should be accounted for under AASB 10XX. However, if a charity provides many services to the



disadvantaged, one of which is counselling services, and it receives a grant for \$X to provide counselling services to the disadvantaged over a one year period, it may conclude that the grant would be accounted for under AASB 15. Based on the current examples, potentially different accounting may arise for grants that, in substance, are the same.

The Board may also want to consider how the guidance with respect to implied performance obligations in AASB 15 paragraph 24 connects to the need for a performance obligation to be 'sufficiently specific.'

3. Do you agree a not-for-profit entity would recognise a donation component if there is evidence of customer intention and the donation component is separately identifiable?

We agree with the proposals in the ED. However, paragraph IG28 implies that separation of a donation component should only be performed if the donation component is material at the contract level. For-profit entities must consider materiality at an aggregate level. Despite this, we accept the proposed principle is a practical approach for not-for-profit entities on the basis of cost/benefit. However, the Board should consider whether entities should be prohibited from recognising a donation component if it is material at an aggregate portfolio level and the criteria are met.

Paragraph BC52 further implies that materiality assessments at a contract versus portfolio level are a policy decision which is inconsistent with that in paragraph IG28.

4. Should the requirements for the recognition of volunteer services be the same for all not-for-profit entities regardless of whether they operate in the public or private sector?

We generally do not support 'optional' provisions within accounting standards because they do not promote consistency and can make it more difficult for users to understand and compare financial reports. However, we accept recognition of volunteer services should be optional for private not-for-profit entities for practical reasons, provided the fair value of those services can be measured reliability.

In our view, AASB 10XX should only apply to not-for-profit entities. As such, the guidance in paragraphs 19-24 should be simplified to only differentiate between private sector and public sector not-for-profit entities. The inclusion of specific reference to 'local governments, government departments, general government sectors (GGSs) and whole of government' adds unnecessary complexity and implies this guidance is applicable to some public for-profit entities. For-profit guidance should be relocated to another Australian Accounting Standard if retained.

5. Do you agree that when inventories are donated to a not-for-profit entity materiality should be assessed at an individual transaction basis without reassessment at a portfolio or other aggregate level?

We agree with the proposals in the ED. However, see question 3 above with respect to providing clarity on whether this is a requirement or policy decision.



6. Do you consider the definition of ‘contributions by owners’ still necessary in Australian Accounting Standards and if so, which definition would you prefer using?

Our preferred option is to keep a principles-based definition of ‘contributions by owners’ in Australian Accounting Standards for not-for-profit entities. We recognise there is no equivalent definition in IFRS for for-profit entities. However the guidance is helpful for not-for-profit entities given the volume of transactions on a non-arms-length basis. This guidance helps to minimise diversity in practice.

The current definition in AASB 1004 is too narrow and not principles-based. Application can be problematic as some transactions which are equity in substance are recognised as income per the situations described in BC88. We recommend the IPSASB definition of ‘contributions by owners’ be considered to address this concern. Further examples on how to apply this definition may be included to illustrate concepts such as: symmetry of contributions and distributions, movements of assets and businesses between wholly owned subsidiaries, and assumption of liabilities on behalf of others in the group.

If the Board determines not to use a principles-based definition of ‘contributions by owners’ in AASB 10XX, we recommend that the current guidance be removed to enable application based on substance.

7a. Should AASB Interpretation 1038 be withdrawn, retained with a narrower application or retained without amendment?

In our view, AASB Interpretation 1038 should be withdrawn and, as noted above, any useful examples or principles relocated to AASB 10XX to provide guidance on how a broader definition of ‘contributions by owners’ should be applied. It should not be retained without amendment.

AASB 10XX should only apply to not-for-profit entities. For-profit entities, regardless of being public or private sector, should be able to state compliance with IFRS. As such, public for-profit entities that have previously relied on AASB Interpretation 1038 should look to IFRS to determine whether a transaction is, in substance, an equity transaction. The guidance in the AASB Framework and the substance of the transaction should be considered.

7b. Should requirements for restructures of administrative arrangements be included in Australian Accounting Standards?

Consistent with above, where a broader definition of ‘contributions by owners’ is provided, examples of how to apply the principles to internal restructures resulting in movements of assets and businesses among entities would be useful to preparers.

If the Board determines not to use a principles-based definition of ‘contributions by owners’ in AASB 10XX, we recommend that the current guidance be removed to enable application based on substance.



7c&d. Should requirements for distributions to owners and liabilities of government departments assumed by other entities be included in Australian Accounting Standards?

Consistent with above, where a broader definition of ‘contributions by owners’ is provided, examples of how this may be applied to distributions to owners and liabilities of government departments will be useful to preparers and will aid consistency.

If the Board determines not to use a principles-based definition of ‘contributions by owners’ in AASB 10XX, we recommend that the current guidance be removed to enable application based on substance.

7e. What are the practical implications if the definition of ‘contributions by owners’ and AASB Interpretation 1038 were to be withdrawn?

Practically, if there is a perceived gap in guidance, the State Treasuries may issue their own guidance to aid consistency across government entities.

A possible implication of withdrawing the definitions and guidance may be that the States could retain existing practice instead of applying a substance based approach. In this case, transactions may be accounted for through profit or loss when recognition through equity better reflects the substance.

8. Do you agree with the ED’s disclosure requirements regarding compliance by government departments with appropriations?

We agree with these proposals; however the disclosure requirements apply to ‘any other public sector entities’ that obtain all or part of their spending authority from parliamentary appropriations. This scope could capture for-profit entities where they are direct recipients of a parliamentary appropriation. Where this could be the case, we suggest that the for-profit disclosure requirements be relocated given this ED is for not-for-profit entities.

9. Do you agree with the proposed transitional provisions in Appendix C of [draft] AASB 10XX?

We agree with the proposed transitional provisions, however the Board should consider whether relief should be provided for previously contributed non-financial assets and finance lease assets received that were not recognised at fair value. While this may provide meaningful information to the users of the financial statements, the effort and cost to determine such values may be extensive for some entities.

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

Other than matters already noted, we are not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.



11. Whether, overall, the proposals would result in financial statements that would be useful to users.

We agree that the proposals would result in more consistent and improved financial statements within the not-for-profit sector and between the not-for-profit and for-profit sectors. However, these improvements should be balanced with the Board's consideration of the outreach and comments received from smaller not-for-profit entities.

12. Whether the proposals are in the best interests of the Australian economy.

As noted above, while the proposals would lead to greater consistency and alignment, the combined guidance in ED 260 and AASB 15 may introduce significant complexity and costs to smaller not-for-profit entities. The Board should carefully consider the comments from these organisations to ensure the cost and benefits of the proposals are appropriately weighed.

Other Comments

Application of AASB 15

The ED provides guidance and examples to assist a not-for-profit entity determine whether its transactions fall within AASB 15, however limited guidance is provided on the application of AASB 15 to not-for-profit transactions. We recommend that the Board consider whether any additional implementation guidance or examples should be provided to show how AASB 15 would apply to not-for-profit transactions, specifically around cost capitalisation, discounting, determining whether a good or service is distinct and measuring progress towards when a performance obligation is satisfied. One specific example which could be included is a complex government grant which contains the requirement to provide multiple goods and services to various beneficiaries over a period of time. Many not-for-profit entities are not as familiar with the application of AASB 15 and these examples may be helpful.

Operating Leases

While the accounting for donated finance leases, volunteer services and non-financial assets are discussed in the proposals, the accounting for donated operating leases are not. We recommend guidance be provided on operating leases. One option is to treat operating leases similar to volunteer services in AASB 10XX, whereby not-for-profit entities would have a policy option to recognise income where the fair value of the lease is reliably measurable.

ED 263

The IASB has recently deferred the application date of IFRS 15 until 1 January 2018. The application date of ED 260 should align to the application date of AASB 15 which is proposed to be deferred through ED 263 *Effective Date of AASB 15 Revenue from Contracts with Customers*. Early adoption of ED 260, like AASB 15, should be permitted as long as a not-for-profit entity adopts both simultaneously.