

The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street
West Victoria 8007

14th August 2015

Dear Sir,

Submission on Exposure Draft ED 260 Income for Not-for-Profit Entities

On behalf of the Northern Territory Local Government Accounting Advisory Committee (LGAAC) I write regarding the above exposure draft.

LGAAC is a Committee set up under the Northern Territory Local Government (Accounting) Regulations to provide advice to the NT Government on both contemporary financial management and accounting practices and appropriate legislative changes necessary to improve standards of financial management and accounting in local government.

Overall Opinion

Overall LGAAC believes that ED 260 goes a fair way to provide clarity about the application of AASB 15 and the changes made by the new draft standard will make it clearer how income by not-for-profits should be treated. However, there are some further changes that would make the accounting for income align better to the spending conditions attached to that income and therefore achieve higher comparability and transparency in the financial statements of these entities.

LGAAC considers that the definition of a performance obligation is too tight in regard to conditions about the timeframe over which income is to be used. This is because in the absence of another specific performance obligation the concept of control becomes the only factor taken into account in deciding when to record the receipt of income, despite the underlying condition of when the funds are to be spent.

Whilst we understand the importance of control, we believe that better matching is needed between the timing of the receipt of income and when the related expenditure is due to be incurred. This would provide greater clarity for users of General Purpose Financial Statements.

This issue is highlighted in example 3B where the charity records the income in the year of receipt but then has to provide the services in the following year, recording a liability at the end of the following year should it fail to meet the condition that the funds be spent by the 30th June that year. Thus looking at the financial records for this grant in the year ending 30th June 20X0 there is a surplus of \$2m with no "apparent" liability, then in the year ending 30th June 20X1 there is expenditure of \$2m or a mix of expenditure and a recording of a liability to that value resulting in a deficit for the organisation of \$2m. Without a clear understanding that the charity's results are affected by the early receipt of this grant the financial statements of the year ending 20X1 would be rather concerning if one was considering donating to the charity. Furthermore, at the end of the year 20X2 when the comparative result from 20X0 disappears there would be even more of a concerning picture shown by the Income and Expenditure statement. This problem is exacerbated by the fact that the one grant may not be the only grant received by the entity and thus the fluctuations in surplus and deficit will be affected due to timing of receipt of those grants, to establish the underlying results of the entity would be extremely difficult.

If one looks at the financial position of the charity in example 3B at the 30th June 20X0, considering the concept of ability to pay the charity's debts as and when they fall due, one could be mistakenly drawn into the concept that there is a fair and reasonable chance it will when comparing its current assets to its current liabilities. This can be done without realising that in fact \$2m of the cash at bank figure will have to be spent in the following year on achieving the charity's overall objectives during that year and if not spent will have to be returned.

In this example, greater clarity in the financial statements could be achieved by eliminating the requirement under IG15, as the operations of the charity in themselves are the performance obligation which is being funded by the income received. To provide clearly comparable financial statements it is also important to recognise revenue in the period that those operations are going to be undertaken.

Example 3C is of concern as it suggests that the fact that the charity is not able to retain the interest on the grant funds it does not in fact gain control of those funds until the time related condition allows for the funds to be expended. We are not sure how obtaining control is linked to whether the charity has the right to retain the interest or not?

Another example of the issue can be found when looking at how the draft standard deals with appropriations from one level of government to another where there are no conditions placed on the expenditure such that it is considered sufficient to establish a performance obligation, but that there is an expectation that the funds will be expended in a specific timeframe. The problem is especially highlighted where multi-year agreements exist, but even those that are paid in advance of the year for which they have been promised we believe are treated incorrectly under the new draft standard.

Under paragraph 11, of the draft standard, grants and/or appropriations that only have a time related condition and no other specific performance obligation, would be recorded as income in the year in which they are actually received or when control has been obtained. However, the expenses related to those funds may not be incurred by the receiving entity until later years. This leads to a lack of comparability across years as well as between entities.

There is an argument that this issue could be addressed in the notes to the accounts by adequate disclosure. We believe that this provides less transparency than the alternative suggested, being that recognition of income should be allocated to the period of operations to which that income was provided for.

Example 4 is a good example of when the draft standard will provide useful guidance, because there is no performance obligation and no set time within which the monies are to be spent.

Specific Matters for Comment

1) In relation to the AASB's proposal to replace the reciprocal / non-reciprocal transfer distinction in AASB 1004 with income recognition requirements based on whether a not-for-profit entity needs to satisfy a performance obligation:

(a) do you agree that this proposal would provide a faithful depiction of a not-for-profit entity's financial performance?

No

(b) if not, what alternative approach to income recognition would you recommend for not-for-profit entities? Please provide your reasons.

The elimination of the reciprocal/non-reciprocal transfer distinction is welcome, however, the need to satisfy a performance obligation needs to be extended so that funds provided for the operations of the entity in a particular period are recognised in that period, without the need to have another specific performance obligation attached.

We believe that the discussion, at the foot of page 11 of ED260, of the IMF Manual, treatment of cash when a grant is received for construction of fixed assets over several periods, shows the correct methodology to provide users with a clearer comparability between the financial statements of organisations over those years. Adding the complication to ascertain if conditions are "sufficiently specific" continues the previous problem where a lack of clarity in the reciprocal / non-reciprocal provisions made it unclear as to what is and what isn't likely to be included in the results provided.

Greater clarity could be achieved by eliminating the requirement under IG15, as operations of the not-for-profit organisation in themselves are the performance obligation being funded by income received, this along with a timeframe should be sufficiently specific to prove the performance obligation requirements of AASB 15. To provide clearly comparable financial statements it is also important to recognise such revenue in the period during which the operations being funded are paid for.

2) In relation to the AASB's proposal that, to qualify as a performance obligation, a not-for-profit entity's promise to transfer a good or service to a counterparty in a contract must be 'sufficiently specific' to be able to determine when the obligation is satisfied (see paragraph IG13 of Part A):

(a) do you agree with this proposal?

No.

(b) if not, what factors or criteria should apply to determine whether a not-for-profit entity has a performance obligation? Please provide your reasons.

As mentioned above, the obligation to provide services during a particular period in itself should pass the criteria of whether a performance obligation exists. This is because the operations of a not-for-profit organisation by nature are directed at the performance of the objectives of that organisation and are not aimed in any way at making a profit for distribution to external parties. We believe this factor alone should satisfy the other requirements to establish there are specific performance obligations.

3) Do you agree with the proposal in paragraphs IG19-IG30 of Part A that a not-for-profit entity would recognise a donation component in a contract with a customer as immediate income only if:

(a) a qualitative assessment of available evidence indicates that the customer intended to make a donation to the not-for-profit entity; and

(b) the donation component is separately identifiable from the goods or services promised in the contract? (See also paragraphs BC36-BC49 of the Basis for Conclusions.)

Yes

If not, under what circumstances should a not-for-profit entity identify and account separately for a donation that is provided as part of a contract with a customer?

4) In relation to the AASB's proposals to:

(a) permit any not-for-profit entity to recognise volunteer services as income if the fair value of those services can be measured reliably; and

(b) carry forward the requirement in paragraph 44 of AASB 1004 that particular public sector entities must recognise volunteer services if those services would also have been purchased if they had not been donated,

the AASB seeks views on:

(a) whether the requirements (if any) for the recognition of volunteer services should be the same for all not-for-profit entities, regardless of whether they operate in the public or private sector; and

Yes

(b) if your answer to (a) is 'yes', whether the recognition of volunteer services should be:

(i) optional, provided that the fair value of those services can be measured reliably; or

(ii) required if those services would also have been purchased if they had not been donated.

No opinion either way, however, there seems to be an anomaly here with recognition of volunteer services as in paragraphs 19 & 20 only mentions the recording of income in relation to a Government entity, whereas paragraph 21 discusses the recording of income and a corresponding asset or expense for a non-public not-for-profit entity. This is confusing, as to only measure the income side would inflate the recorded result for the year and would seem to be incongruent with double entry bookkeeping.

5) Do you agree with the proposal in paragraph 38 of [draft] AASB 10XX that, when inventories are donated to a not-for-profit entity other than as part of a contract with a customer, assessments of whether the donations are material should be made on an individual transaction basis without reassessment at a portfolio or other aggregate level? (See also paragraphs BC50-BC51 of the Basis for Conclusions.)

No opinion

6) Australian Accounting Standards applicable to for-profit entities do not include a definition of 'contributions by owners'. Further, concerns have been expressed by some that the definition of 'contributions by owners' in AASB 1004 is too narrow. Do you consider that a definition of 'contributions by owners' is still necessary, or appropriate, in Australian Accounting Standards?

No opinion

If so, would you prefer using:

(a) the definition of 'contributions by owners' presently in AASB 1004; or

(b) the definition of 'ownership contributions' in the Public Sector Conceptual Framework issued by the International Public Sector Accounting Standards Board (IPSASB)? (See also paragraphs BC84-BC91 of the Basis for Conclusions.)

7) The AASB also seeks views on the following issues related to contributions by owners:

(a) whether, in view of concerns expressed by some that using AASB 1004's definition of 'contributions by owners' in AASB Interpretation 1038 Contributions by Owners Made to Wholly-Owned Public Sector Entities (which includes for-profit public sector entities in its scope) might prevent a for-profit entity in the public sector from making an unreserved statement of compliance with IFRSs, AASB Interpretation 1038 should be:

(i) withdrawn;

(ii) retained but with narrower application [that is, limited to not-for-profit entities in the public sector, and possibly also confined to identifying which not-for-profit public sector entities should account for transfers between them when they are controlled by the same parent (government)]; or

(iii) retained without amendment? (See also paragraphs BC84-BC94 of the Basis for Conclusions.)

(b) whether requirements for restructures of administrative arrangements (presently set out as paragraphs 54-59 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraph BC90(b) of the Basis for Conclusions);

(c) whether requirements for distributions to owners (presently set out as paragraphs 49 and 53 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraphs BC94-BC96 of the Basis for Conclusions);

(d) whether requirements for liabilities of government departments assumed by other entities (presently set out as paragraphs 39-43 of AASB 1004) should still be included in Australian Accounting Standards (see also paragraphs BC97-BC98 of the Basis for Conclusions); and

(e) the practical implications if the definition of 'contributions by owners' and AASB Interpretation 1038 were to be withdrawn?

No opinion

8) In relation to disclosure requirements regarding compliance by government departments with appropriations, do you agree with:

(a) omitting the requirement in paragraph 64(e) of AASB 1004 to disclose the nature and probable financial effect of any non-compliance by the government department with externally-imposed requirements for the period, other than any non-compliance reflected in material variances between amounts appropriated and amounts expended? (See paragraphs BC99-BC103 of the Basis for Conclusions.)

(b) extending the scope of the retained disclosure requirements for government departments (ie those regarding any non-compliance reflected in material variances between amounts appropriated and amounts expended) to also apply to any other public sector entities that obtain part or all of their spending authority from parliamentary appropriations? (See also paragraphs BC99-BC103 of the Basis for Conclusions.)

No opinion

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

(a) do you agree with the transitional provisions for non-financial assets and finance lease assets and liabilities, the cost of which was not measured at fair value on initial recognition; and

(b) do any other issues warrant additional transitional provisions and, if so, which transitional provisions do you suggest? (See also paragraphs BC104-BC109 of the Basis for Conclusions.)

No opinion

10 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) not-for-profit entities; and

(b) public sector entities, including GAAP/GFS implications (discussed above).

As mentioned above we believe that the discussion, at the foot of page 11 of ED260, of the IMF Manual, treatment of cash when a grant is received for construction of fixed assets over several periods, shows the correct methodology to provide users with a clearer comparability between the financial statements of organisations over those years. Adding the complication to ascertain if conditions are “sufficiently specific” continues the previous problem where a lack of clarity in the reciprocal / non-reciprocal provisions made it unclear as to what is and what isn’t likely to be included in the results provided.

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

No – see our comments above.

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

The issue needs to be addressed, but as noted above the draft standard falls a little short of fixing the entire problem.

If all the issues were fixed within the proposals then they would be in the best interests of the Australian economy. Matching income with associated expenditure helps the users of their financial reports better manage their resources for the benefit of the community.

13) Unless already provided in response to specific matters for comment 1 – 9 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

The benefits are highlighted above in provision of clearer, more comparable and transparent financial statements.

We would be happy to provide the Australian Accounting Standards Board with any further information on the above answers as many be necessary to clarify our opinions.

If you require any further information please do not hesitate to contact me either by email at chris.kendrick@macdonnell.nt.gov.au, on 08 8958 9631 or on my mobile 0427 397 701.

Yours sincerely,



Chris Kendrick (Mrs)
Chairman – Local Government Accounting Advisory Committee