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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
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14 August 2015

Dear Kris

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

I am enclosing a copy of World Vision Australia's response to the Australian Accounting Standards Board's exposure draft ED 260 *Income of Not-for-Profit Entities* (ED).

We support the Board's overall aim to update the accounting requirements for income recognition for not-for-profit entities. The attached response highlights our organisation's background and the potential implications of the proposed ED for our organisation as well other entities in the not-for-profit sector.

I would welcome the opportunity to discuss our views at your convenience. Please do not hesitate to contact me on (03) 9287 2287 if you would like to discuss our comments further.

Yours faithfully,



Rebecca Lees
Chief Financial Officer
World Vision Australia

Preamble

This paper sets out the submission of World Vision Australia (WVA) in response to the AASB Exposure Draft ED 260 (“ED 260”). The submission primarily addresses matters that are important and relevant to WVA as well as noting other matters which we consider would be of concern to the not-for-profit sector generally.

Organisation Background

WVA is a Christian relief, development and advocacy organisation dedicated to working with children, families and communities to overcome poverty and injustice. It is part of the World Vision International Partnership, with operations in more than 90 countries. WVA is Australia’s largest overseas aid and development organisation, operating primarily to assist overseas communities living in poverty. It also carries out development work in Australia with Indigenous communities, working collaboratively with government and non-government organisations in Australia. WVA is a Public Benevolent Institution with various tax endorsements and is registered as a charity with the Australian Charities and Not for Profits Commission (ACNC).

World Vision Australia operates four main revenue streams as follows:

- *Pledge and Non-pledge (one-off) donation products*
This includes the Child Sponsorship program, as well as other donation products such as Child Rescue, Gift Catalogue and the 40 Hour Famine. These programs focus on empowering communities and families to break the cycle of poverty and bring about long-term sustainable change. The projects cover a multitude of activities including water and sanitation, health and hygiene, food and agriculture, education, children’s rights, livelihoods and economic development. In addition, WVA also seeks donations from the public in the wake of significant emergencies overseas to provide emergency food, shelter, water and sanitation and child-friendly spaces for communities in critical need.
- *Corporates, Major Donors, Churches and Community Groups*
Corporate donors may enter into workplace giving arrangements whereby their employees donate funds and the corporate ‘matches’ the employee donation. Further, corporate and church groups may also partner with WVA to be a major financial contributor to a specific project. Major donors are individuals that donate significant funds in their own right and may be a material financial contributor to a specific community project.
- *Government Grants*
WVA receives grants from a number of government bodies both domestically and internationally, particularly the Department of Foreign Affairs and Trade (DFAT) within the Australian Government. There is a Head Agreement in place with DFAT which specifies broad parameters of its engagement with WVA and then specific Funding Orders which relate to funding of specific grants on an individual basis.

- *Multilateral Donors*
WVA enters into grant contracts negotiated between overseas World Vision offices and multilateral institutions, such as United Nations World Food Programme, to deliver projects in countries identified as requiring assistance. WVA and the overseas World Vision office enter into an agreement with the donor agency that indicates that all the World Vision organisations involved are jointly and severally liable as the principal recipients of the funds from the donor and for the responsibilities to fulfil the obligations to the donor. In addition, WVA and the overseas World Vision office enter into a project agreement documenting WVA's responsibility for project design, monitoring and reporting to the donor.

In the case of the United Nations World Food Programme, as co-parties to the agreement, WVA provides the funds to receive, store, distribute and handle food for distribution in emergency situations in addition to monitoring and oversight of the projects. In return, WVA recognises revenue based on its portion of the total value of the distributed food.

Executive Summary

WVA recognises the importance of reforming the revenue standard to better reflect the economic substance of such transactions. Current practice in many organisations may result in revenue being recognised too early when it should in fact be deferred to accurately reflect when it is earned. A revised approach to revenue recognition for not-for-profit entities that results in more economically representative recognition of revenue than is currently achieved under the existing standard is welcomed.

Currently the proposed standard requires income received from a contract that is legally enforceable and includes 'sufficiently specific' promises in relation to the required goods and services, to be recognised in accordance with AASB 15 Revenue from contracts with customers ('AASB 15').

The challenges specific to WVA in applying the proposed changes are summarised as follows:

- Determination of whether our contracts with donors include 'sufficiently specific' promises to deliver goods or services to our beneficiaries.
- Should the determination be made that income should be recognised in accordance with AASB 15, the appropriateness of application of AASB 15 to a not-for-profit environment, with specific reference to:
 - The ability to measure the obligations to determine if these have in fact been met to allow the revenue to be recognised.
 - Allocation of the transaction price to the performance obligations.
 - The costs and resources required to transition the recognition methodology currently adopted to that proposed by AASB 15 will be significant.

In considering an alternative approach to income recognition for income received by a not-for-profit we believe the principles included in AASB 120 Government Grants and Disclosure of Government Assistance ('AASB 120') to be appropriate and relevant.

If the AASB decides to proceed with the proposals in ED 260, and requires income to be recognised in accordance with AASB 15 rather than AASB 120, we would recommend that the AASB:

- Provide more useful and detailed implementation guidance and examples for exactly how AASB 15 would apply in a not-for-profit context. The complex agreements (discussed in more detail below) that we as an organisation enter into would necessitate very detailed guidance to be included in the standard in order to provide adequate direction on how to account for these.
- Review the disclosure requirements in AASB 15 to consider whether additional relief should be provided for not-for-profit entities specifically, or at least provide practically relevant examples of how these disclosures might be operationalised in a not-for-profit context.

Practical Examples

WVA has identified the following three examples to illustrate the complexities of certain donor arrangements and as a result the challenges we face in relation to application of the current ED 260. These challenges are more specifically related to when the income falls within the remit of AASB 15.

Example 1: Corporate Donor

WVA enters into an agreement with Company XYZ for funding to provide water to 50,000 people in a specific community in Lesotho. Within the agreement there is a clause stipulating that future donations from the donor are subject to them being satisfied with the annual project report covering project activities and finances from the previous financial year. The agreement does not discuss recovering money if obligations are not met.

The agreement specifies that WVA will build 25 latrines per year over three years. However, in year 1 due to circumstances (such as political unrest, changes to original estimated costings of the project or a devaluation of foreign exchange) WVA can only build 22 latrines. WVA informs the donor that the goal could not be achieved and the donor agrees that only 22 latrines will be built or alternatively allows the funds to be extended for a future period.

The challenges this scenario poses are summarised as follows:

- Is there an enforceable contract that is intended to be legally binding?
 - Recoverability of funds or enforcement of performance obligations (as discussed in paragraph IG4 of the proposed appendix E to AASB 15) is not addressed under the agreement. However, there does appear to be an implied performance obligation.
 - In some cases, it may be difficult to determine whether a contract is legally binding without significant investment in legal advice.
 - Legal enforceability is not the sole determinant of whether an obligation exists, as demonstrated by the concept of constructive obligations in AASB 137.
- Is there a sufficiently specific promise? What is WVA's performance obligation? Is it to alleviate world poverty, improve sanitation in the specified community or build 25 latrines? At which point in these examples does the promise become 'sufficiently specific'? It would be helpful to provide illustrative guidance to enable judgment to be appropriately applied in this instance.
- How do we determine when our performance obligation is satisfied? Is it when the 22 latrines are built, or when the target of 25 latrines is completed?
 - Many not-for-profits work in a challenging environment where outputs and outcomes may vary due to changing circumstances. In many cases, donors may not seek to recover funds or enforce performance (even if they can legally do so). If a donor agrees to consider a performance obligation satisfied when 22 latrines are completed, would this be regarded as a modification to the agreement? Would this uncertainty undermine the view that the performance condition is 'sufficiently specific'?
 - It is also unclear how the notion of a 'sufficiently specific' promise relates to 'distinct' performance obligations under AASB 15 – which would ultimately determine how revenue will be apportioned and recognised.

- Do we apportion our revenue at a year-end cut off point on a pro-rata basis with the number of latrines built? What if the donor agrees to revise the target to 22 latrines, given that the project was delayed due to the examples listed above?
 - Additional guidance would be appreciated in determining whether a performance obligation is satisfied at a point in time versus over time, specifically methods for measuring progress when a performance obligation is satisfied over time.
- The example above is one project in one country. During the 2015 financial year, WVA engaged with 61 corporate donors covering 36 projects over 20 countries and communities and the performance obligations differ between donors and projects. Would WVA need to identify and monitor performance obligations on a contract by contract basis? We acknowledge that AASB 15 allows a portfolio approach to be adopted, provided an entity reasonably expects the effects on the financial statements would not differ materially from applying the standard to individual contracts. However, given the varying nature of the underlying contracts in terms of the performance obligations and related activities and geographical areas impacted, there may be challenges in justifying the use of this approach to these types of contracts.

Example 2: Government Grant Funding

WVA enters into a block funding agreement with a government agency (for example DFAT). A funding amount is specified in the contract and the block grant is distributed across 75 projects in multiple countries. For each project, WVA develops a project plan that details the country and project activities the funds are to be spent on, including project objectives, outcomes and targeted beneficiaries. In each case, WVA partners with a World Vision National Office (NO) in each country. WVA works with the NO on the design, monitoring and evaluation of the project to ensure it meets the needs of the government donor, while the NO performs the implementation of the project in the field working with the beneficiaries.

A project plan contains a commitment of the following nature: “World Vision’s Water, Sanitation and Hygiene Project in Country X, supported by Donor Y, aims to improve sanitation, hygiene and access to safe water for 4,500 men and women and 4,800 children in 23 communities of a specified District”. Examples of the outcomes included in such a project are as follows:

- Five communities (300 households) have improved access to, and use of, safe water infrastructure. Hygiene behaviour change interventions designed by the communities are implemented by 300 target households in five target communities.
- 60% of 300 households in five target communities experience improved sanitation and hygiene behaviours. 80 households have a hand-washing facility with soap. Activities planned and undertaken by the target population result in 300 households using and maintaining sanitary latrines.
- The five target communities (300 households) mentioned have access to a range of different sanitary hardware options. 300 households have improved access to, and use of, safe water infrastructure in the target communities.

WVA is required to report on the financial and non-financial performance of this project, and the other 74 projects within the block funding grant. From a financial perspective, the underspends and overspends of the individual projects are netted off and considered in aggregate across the grant portfolio.

- The donor requires WVA to calculate interest earned and foreign exchange gains and losses on donor funds. Any interest earned or foreign exchange gain must be spent exclusively for the approved activity or returned to the donor.
- Where there is overspending on the block grant, WVA is expected to cover the overspend.
- Where there is underspend, if it is within 10% the donor allows the funds to be rolled over to the next period.
- Where there is more than 10% underspend the donor may:
 - (a) Approve the rollover to be spent in the following financial year;
 - (b) Reduce the next tranche payment to WVA by the amount of unexpended funds or a portion thereof as agreed; or
 - (c) Require WVA to return the unspent funds.

This situation has not previously occurred with WVA and the donor's response to this scenario is untested.

From a non-financial perspective, non-financial metrics are reported against the original plan. Where delivery does not meet plans (which may be due to delays outside the project's control), explanations are required to be provided and this rarely results in any funds being returned where plans are not met.

The challenges this scenario poses are summarised as follows:

- While there is an enforceable contract, is there a 'sufficiently specific' promise within this contract? We acknowledge that it is not the intention of the standard to view outcomes as promises however we request that in the drafting of the standard it is made clear whether it is 'outcomes' (what you aim to achieve), or 'outputs' (what you will provide) that are required for a sufficiently specific promise. Examples may help to ensure consistent application of the guidance.
- If there is a sufficiently specific promise, how does WVA determine when these obligations are fulfilled? Is it when the funds are provided to the NO, or when the individual projects are completed or when the donor approves the acquittal of funds and the report back on the projects is submitted and accepted, regardless of whether the initial plans were achieved in full? This highlights the complexity of applying the five-step model included in AASB 15 in the not-for-profit context and underscores the need for additional implementation guidance if the AASB proceeds with the proposals to require application of AASB 15 to not-for-profit funding arrangements.
- Would WVA need to identify the performance obligation for each of the projects and apportion the grant revenue across each project?

Example 3: Multilateral Grant Agreements

WVA is a co-operating party to a multi-party contractual agreement between World Vision International, World Vision Canada, World Vision Japan, World Vision Ghana and the United Nations World Food Programme to provide food to a community in Ghana. The obligation to perform the services lies with World Vision Ghana and WVA has an obligation to monitor and oversee the project. The funds for this project are initially transferred to World Vision International who then transfers the money to World Vision Ghana.

The challenges this scenario poses are summarised as follows:

- Assuming there is an enforceable contract and a sufficiently specific promise, given the multi-party nature of the contract how does WVA determine who the performance obligation is to when these appeared to be shared and liability is shared (as parties are jointly and severally liable)? Who is the 'customer' in this scenario – is the performance obligation to World Vision International, World Vision Ghana, the World Food Programme or the beneficiaries, that is the community in Ghana? How would the concept of 'principal' and 'agent' play into this scenario?
- Should it be established that the performance obligation is to the community in Ghana, at what point is the performance obligation met? At the point the funds are provided, the project oversight completed or when the community receives the goods or services as contained in the agreement?
 - If the AASB decides to proceed with its proposals to require not-for-profit entities to apply AASB 15 of contracts that include a sufficiently specific promise, the questions above highlight the need for more not-for-profit specific guidance for many concepts (beyond just scope) in AASB 15.

Responses to Questions in ED 260

Q1: 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:

- **Do you agree that this proposal would provide a faithful depiction of a not-for-profit entity’s financial performance?**
- **If not, what alternative approach to income recognition would you recommend for not-for-profit entities? Please provide your reasons.**

WVA recognises the importance of reforming the revenue standard to better reflect the economic substance of such transactions. The proposed removal of the concept of reciprocal/non-reciprocal arrangements should address the current practice within the not-for-profit sector of upfront income recognition. This practice may result in revenue being recognised too early when it should in fact be deferred to accurately reflect when it is earned. A revised approach to revenue recognition for not-for-profit entities that results in more economically representative recognition of revenue than is currently achieved under the existing standard is welcomed.

Currently the proposed standard requires income received from a contract that is legally enforceable and includes ‘sufficiently specific’ promises in relation to the required goods and services, to be recognised in accordance with AASB 15.

There are however, significant challenges for an organisation such as WVA to apply the criteria included in AASB 15. These have been raised in the practical examples as set out above.

With specific reference to WVA, the proposed standard may in fact create a misleading depiction of WVA’s statement of financial performance. As a member of the World Vision International (WVI) partnership, WVA is required to distribute its surplus to WVI on a regular basis. WVI then distributes the funds to beneficiaries around the world on behalf of WVA. WVA keeps track of the project expenditure but effectively ‘control’ over these funds was relinquished at the point of transfer to WVI. Accordingly, WVI reports a minimal yearly profit.

Under the proposed new standard, when a contract is deemed to include a performance obligation of a sufficiently specific nature, the revenue is to be recognised under AASB 15. The revenue recognition for WVA would then be deferred until performance obligations are satisfied to the beneficiaries in the field. This may create a misleading result for WVA, as the income and expenses have already been received and distributed to WVI, however the revenue recognition is deferred until the performance obligation is met. If the AASB decides to proceed with the proposals in the ED, and require income to be recognised in accordance with AASB 15 there is a concern that WVA will not achieve fair presentation of the financial performance of the organisation.

In considering an alternative approach to income recognition for income received by a not-for-profit we believe the principles included in AASB 120 Government Grants and Disclosure of Government Assistance (‘AASB 120’) to be appropriate and relevant. The appropriateness and relevance of these would extend to income received by a not-for-profit organisation from both a government and non-government source. We acknowledge that currently this standard is only available to the for-profit sector and relates only to government grants. We also acknowledge the AASB’s considerations outlined in BC14 of ED 260.

However, in our view, the principles that underpin AASB 120 would appear to be more readily applicable to non-reciprocal contributions (whether from government or non-government contributors) received by not-for-profit private sector entities than the principles in AASB 15. AASB 15 primarily deals with exchange transactions, thus its requirements translate imperfectly to non-reciprocal transactions where the intended application of funds is to the benefit of a third party. Unlike exchange transactions, it would be rare for a donor to seek to recover funds or otherwise seek compensation or enforce performance if 'sufficiently specific' promises made by WVA remain unfulfilled or partially unfulfilled, provided that funding is applied in good faith for the agreed purpose. In a not-for-profit context, non-reciprocal contributions are ultimately provided with the aim to compensate the organisation for expenses that will be incurred in carrying out its agreed objectives – the same principle that underpins the requirements of AASB 120.

AASB 120 paragraph 7 stipulates that government grants shall only be recognised when there is reasonable assurance that the entity will comply with the grant conditions and the grants will be received. This would be a more appropriate way to recognise the revenue in the WVA context given the complexities and varying challenges with the identification and measurement of the performance obligation.

In addition paragraph 12 of the standard indicates that government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Applying this principle to all not-for-profit income, particularly in the private sector, would achieve the objective of systematically aligning revenue recognition with the basis on which performance obligations are satisfied, which in most cases materially aligns with the basis in which the related costs are incurred and recognised. In addition to the above, the disclosure requirements included in AASB 120 are more suitable to the not-for-profit environment compared to those required by AASB 15. Given the sheer volume of the projects, the complexities surrounding the identification of the performance obligations and the challenges in measuring these, the disclosure requirements in AASB 15 are considered particularly onerous and costly to implement for an organisation such as WVA. We acknowledge that AASB 15 allows a portfolio approach to be adopted, provided an entity reasonably expects the effects on the financial statements would not differ materially from applying the standard to individual contracts. However, even if the portfolio approach can be shown to be appropriate, there would still be significant complexity involved in identifying and tracking the different performance obligations under the 5-step model in AASB 15, even on a portfolio basis, and would be of little additional informational benefit to users than the model in AASB 120.

If the AASB decides to proceed with the proposals in the ED, and require income to be recognised in accordance with AASB 15 rather than AASB 120, we would recommend that the AASB review the disclosure requirements in AASB 15, to consider whether additional relief should be provided for not-for-profit entities specifically, or at least provide practically relevant examples of how these disclosures might be operationalised in a not-for-profit context.

Q2: 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 whether the obligation is satisfied:

- **Do you agree with this proposal?**
- **If not, what factors or criteria should apply to determine whether a not-for-profit entity has a performance obligation? Please provide your reasons.**

The requirement that a performance obligation must be ‘sufficiently specific’ is an appropriate criterion to determine whether an obligation has been satisfied. However, it is our recommendation that such a requirement should be accompanied with detailed definitive guidance on how this is to be applied.

As is evidenced in the examples shared at the beginning of this submission, there are a number of challenges in application of this principle.

Q3: 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 quantifiable assessment of available evidence indicates that the customer intended to make a donation to the not-for-profit entity**
- (b) **The donation component is separately identifiable from the goods or services promised in the contract?**

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?

We believe it is appropriate to separately identify and measure the donation component in a contract with a customer. However, it is our recommendation that such a requirement should be accompanied with detailed definitive guidance on how this is to be applied.

There are a number of challenges in the practical application of this principle. Often it is difficult to distinguish and separately identify a ‘donation component’ of a contract with a customer. For example, WVA may hold a fundraising dinner and sell tickets to the public for \$200 when the normal commercial price of a ticket may be \$150. This event included celebrity attendance.

- Is the additional contribution of \$50 considered to be a donation? Given the entire event has a fundraising intention, one would assume the motivation for purchasing the ticket would be to support with raising funds/donations.
- What if the commercial value is unknown? How do we then measure the fair value of this transaction and place a value on the celebrity attendance?
- If the customer purchased a ticket for the dinner and made an additional contribution over and above the required ticket price then the donation component could be separately identified, however it may be difficult to measure the fair value of the meal contribution.

As illustrated by the above questions, it is possible there will be substantial diversity in application of the requirements, given the amount of judgment involved in determining:

- Whether the standalone selling price is substantially different from the transaction price, and
- Whether part of the consideration is not “part of the consideration to which the entity expects to be entitled in exchange for the promised good or service”.

Q13: Unless already provided in response to specific matters for comment, 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 amounts of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

In addition to the aforementioned issues, the following is noted with specific reference to the applicability of AASB 15 to income derived from contracts:

- There will be significant costs and resource requirements for the transition to the new standard including:
 - Process change and resourcing costs.
 - Costs associated with changes to the existing IT systems and infrastructure.
 - Renegotiating and updating terms and conditions of existing contracts to accommodate the changes (this will be particularly difficult for contracts where there are multiple parties involved).
- The proposed effective date for the proposals is 1 January 2017. We understand that the intention is that the timing of implementation of the standard is to be aligned to the effective date of AASB 15 (expected to be year ends commencing 1 January 2018). Given the complexity of our environment and the required process changes, we would expect that additional time would be needed to fully comply with these requirements.