Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**AASB 1058 *Income of Not-for-Profit Entities* – targeted outreach**	**Meeting:**	June 2021 (M181)
Topic:	**Overview of the feedback on implementation issues**	**Date of this paper:**	7 June 2021
Contact(s):	Carmen Ridley cridley@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au (03) 9617 7618	**Agenda Item:**	16.1
		Project Priority:	To be determined by the Board
		Decision-Making:	Medium
		Project Status:	Note feedback from stakeholders on implementation issues and consider next steps

Objective of this agenda item

1. The objective of this agenda item is for the Board:

   a) to **consider** implementation issues raised by stakeholders regarding AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities*; and

   b) to **decide** on the next steps.

Reasons for bringing this agenda item to the Board at this meeting

2. Since the release of AASB 1058 and the related AASB 15 NFP Australian implementation guidance, staff have considered a number of implementation issues raised by stakeholders (staff paper 5.1 Termination for Convenience Clauses November 2020, staff paper 22.1 Staff FAQ on Research Grants September 2019). In response to further stakeholder feedback, staff conducted targeted outreach to gain an understanding of the prevalence of the issues raised in practice.[1]

3. This paper highlights the key issues raised to staff by stakeholders and asks the Board to consider whether staff should perform further analysis on the issues, including whether any narrow scope standard-setting may be necessary to clarify the requirements, and/or whether additional educational materials or guidance is needed to assist stakeholders in implementing the Standards.

1 Staff held 23 discussions with stakeholders (preparers and auditors across not-for-profit public and private sectors) either through individual discussions, via emails or in group sessions.

4. Staff note that the post implementation review of AASB 1058 and AASB 15 is scheduled to start in early 2022. However, the timeframe for any output from the PIR process will not result in near-term amendments to the Standards. Therefore, in accordance with requirements of the AASB Due Process Framework, staff think that it is timely that the Board consider addressing the issues raised prior to the PIR process to help ensure consistent application of the requirements.

5. Staff ask the Board to consider the staff summary of the feedback received to date and decide on the next steps at this meeting.

Summary of staff recommendations

6. Staff recommend:

   a) The Board adds a short-term narrow scope project to its agenda to formally consider an approach to addressing the issues identified in paragraph 10; and

   b) The Board approves the project plan to analyse the issues raised by stakeholders further to consider possible narrow scope amendments or the development of additional guidance/examples/educational material.

   Subject to the Board's decisions at June 2021 meeting, staff will bring recommendations on the options available to address the issues in line with Due Process Framework to the Board's September 2021 meeting. Given the targeted nature of the outreach conducted to date, staff will also consider any further feedback from stakeholders following June Board's meeting.

Structure

7. This paper is structured as follows:

   a) Summary of issues identified (paragraphs 8-10)

   b) Description of the issue and preliminary staff analysis (paragraphs **Error! Reference source not found.**1-43)

   c) Staff recommendations and Questions to the Board (paragraph 44)

   d) Next steps (paragraph 45 - 46)

Summary of issues identified

8. The issues raised by stakeholders during the targeted outreach conducted to date indicate inconsistent application or uncertainty relating to some of the requirements of the NFP revenue and income guidance. In addition, some feedback indicated that significant time, cost and effort is being spent by NFP entities in implementing these requirements. Further, some concerns were raised as to the ability of users to understand the financial information.

9. Some feedback indicated that the issues identified are potentially causing divergence in practice in NFP reporting. Feedback noted that the comparability of revenue information is difficult for some entities, including where similar contracts are received by different entities.

10. A summary of the key issues identified from initial stakeholder feedback (including an indication of the stakeholders raising the issue):

    a. Sufficiently specific guidance (auditors and preparers) – paragraph 11 – 14

b. Peppercorn cost exemption (auditors and preparers) – paragraph 15 – 17
c. Upfront payments (auditors) – paragraph 18 – 21
d. Principles of the standards (auditors and preparers)- paragraph 22 - 24
e. Capital grants (auditors and preparers) – paragraph 25 – 28
f. Grants received in arrears (auditors) – paragraph 29 – 30
g. Enforceable criteria (auditors and preparers) – paragraph 31 – 33
h. Documentation (preparer) – paragraph 34 - 35
i. Principal v agency - including appropriate recognition of financial liabilities (auditors) paragraph 36 – 40
j. Termination of convenience clauses (auditors) – paragraph 41 – 42
k. Confusion about the scope of AASB 15 (preparers) - paragraph 43

Staff analysis

Sufficiently specific

11. One of the two criteria for determining whether NFP revenue is within the scope of AASB 15 or AASB 1058 is whether the contract has sufficiently specific performance obligations. Paragraphs F20 and F22 of AASB 15 state:

    'A necessary condition for identifying a performance obligation of a not-for-profit entity is that the promise is sufficiently specific to be able to determine when the obligation is satisfied. Judgement is necessary to assess whether a promise is sufficiently specific. Such judgement takes into account any conditions specified in the arrangement, whether explicit or implicit, regarding the promised goods or services, including conditions regarding the following aspects:
    a. The nature or type of the goods or services;
    b. The cost or value of the goods or services;
    c. The quantity of the goods or services; and
    d. The period over which the goods or services must be transferred.' (AASB 15, par. F20)

    'Whether a promise is sufficiently specific so as to qualify as a performance obligation is assessed separately for each promise and will depend on the facts and circumstances. 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. In addition, there may be other conditions that need to be taken into account in applying the judgement above that may indicate the promise is sufficiently specific'. (AASB 15, par. F22)

12. Staff received feedback from a number of stakeholders, including auditors and preparers, that the term 'sufficiently specific' was unclear and there was confusion in practice as to how the term is to be applied. These stakeholders requested further guidance be included in the Standard (in addition to existing Implementation guidance and Illustrative examples included in AASB 15) to highlight examples of when the sufficiently specific criteria are met, and not met.

13. For example where the funding in the form of a grant is received to employ a member of staff for the next 2 years to deliver services to community recipients in line with NFP entity's objective, some entities interpret this as sufficiently specific and therefore defer the recognition of revenue until the employee costs are incurred, whereas other entities recognise revenue on receipt and the employee expenses over 2 years resulting in different reporting of revenue, expenses and results for the period of the funding.

14. The varying interpretations of sufficiently specific and judgement involved has resulted in diversity even within similar agreements depending on a preparer / auditor stance on how

specific the performance obligations are required to be to meet the sufficiently specific threshold and therefore comparability of NFP financial statements is reduced.

Peppercorn / concessionary lease cost exemption

15. Where a NFP has a peppercorn or concessionary lease, the Board has previously allowed entities to elect to measure the right of use asset arising from this lease at cost, i.e. based on the lease liability rather than being required to fair value the right to use asset in accordance with AASB 1058. The Board communicated that this option was temporary and at its meeting in September 2019 (Action Alert No. 204) confirmed that this option would be in place until the NFP financial reporting framework project was completed.

16. The benefit of recognising the fair value of these concessionary leases compared to the cost to obtain the information was raised by a number of stakeholders, for example a golf club has a lease of $1 per year from the Council for 25 years and if the cost exemption was not in place then they would be required to obtain a fair value for the right to use asset (assume $5m in the example) which would be recognised as income (or through retained earnings) immediately with a $200,000 depreciation charge for the next 25 years.

17. Based on the feedback received, NFP entities are concerned that if, or when, the cost exemption is lifted then it will be a retrospective application rather than prospective and they will be required to obtain fair value information for leases currently in place. In addition, the relief from providing this information has made it harder to obtain information since more time has passed. Accordingly, a number of stakeholders noted that an indication on the future approach to transition provisions would decrease uncertainty for preparers.

Upfront payments

18. Where NFP revenue is within the scope of AASB 15 and a non-refundable upfront payment is charged to the customer, then AASB 15 paragraphs 22 – 30, B48 -B51 and F20 - F27 require an entity to assess whether the upfront fees relate to the transfer of a separate good or service. If there is no separate transfer of goods or services, then the revenue is recognised over the period of the service provided rather than on receipt of the funds.

19. For example, a golf club which charges a joining fee in the first year of membership is most likely to need to estimate the life of a membership and recognise the joining fee over that life.

20. Many stakeholders raised this issue from both an application diversity perspective where some entities are deferring revenue (and recognising a contract liability in accordance with AASB 15) and others are continuing to recognise on receipt for fees which prima facie look very similar and a lack of understanding since the payment is not refundable and therefore the principle of deferral is confusing to boards, management committees, members and other users.

21. The AASB staff included two examples in the NFP revenue Staff FAQs relating to waitlist and enrolment fees in schools, however based on the feedback from the outreach preparers think that these FAQs are too specific and do not provide sufficient explanation to allow an understanding of the principle and why a contract liability is recognised when the funds will never be repaid.

Principles of the standards

22. NFP entities need to refer to two accounting standards for revenue and income requirements and guidance. These entities have to determine which is the relevant standard based on whether the contract is enforceable and contains sufficiently specific performance obligations. The accounting outcomes from AASB 15 and AASB 1058 are different and stakeholders noted

that this determination poses some implementation challenges (for example, sufficiently specific criterion discuss in par. 12-15 and enforceable in par. 32 – 34 of this paper).

23. In addition, the reason for requirements being provided across different standards is not well understood. In particular, many stakeholders did not understand the Board's reasoning for not applying the requirements of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* principles for NFP entities[2]. Stakeholder feedback noted that this issue is causing confusion for many stakeholders and providing challenges for NFP entities in explaining financial statements to boards, donors, members and other funding providers. Stakeholders in the targeted outreach indicated, that in many cases, this is resulting in management account revenue being reported on a different basis from the financial statements creating additional work for NFP finance teams.

24. Overall, the stakeholder feedback indicates that the lack of understanding is resulting in diversity of accounting treatment in some circumstances, as well as instances where entities are using the incorrect accounting standard for their revenue accounting.

Capital grants

25. Stakeholders raised two issues in relation to accounting for funding received to acquire or construct a recognisable non-financial asset to be controlled by the NFP entity as outlined in AASB 1058.

26. AASB 1058, paragraph 15(a) requires the entity to use the financial asset received to acquire or construct a recognisable non-financial asset to **identified specifications** [emphasis added]. Stakeholders have noted there is no guidance with the standard or basis for conclusions regarding how specific the 'identified specifications' need to be. The illustrative examples in AASB 1058 include the following scenarios for the asset:

- early learning centre to include two rooms for the delivery of the early learning programs (Example 9); and
- 16 intensive care hospital beds (Example 10).

27. Stakeholder feedback indicates there are divergent views on how much detail is required in order for an asset to satisfy the requirements in paragraphs 15 – 17 which allows income can be recognised over the construction period or on acquisition of the asset rather than on receipt of the funds. For example, there may be differing views whether a single objective NFP entity that receives funding to construct a building to perform its operations meets the identified specifications criteria or not.

28. The second concern raised by the stakeholders in relation to income recognition was that the two illustrative examples in AASB 1058 referred in paragraph 27 above reflect recognition on acquisition of the hospital beds and income recognised over time as the early learning centre building is constructed. There are divergent views about whether income relating to a construction can always be recognised over the construction period or whether for example, if the building is not on the land owned by the NFP the income would be recognised once construction is complete.

Grants received in arrears

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2 AASB 1058 Basis for Conclusions BC15 – BC 17 outline reasons why the Board decided not to extend AASB 120 to apply also to not-for-profit entities.

29. AASB 1058 requires the recognition of an asset once it is controlled by the entity, however where grants are received in arrears, i.e. some of the work is performed prior to the funding being received, then stakeholder feedback is that there are divergent views on whether an asset should be recorded and if an asset exists then what is the nature of the asset.

30. AASB staff released an FAQ in 2020 which provided some guidance and an example for a grant received in arrears, however based on the feedback from stakeholders, the divergence in practice is still present with some preparers not recognising an asset (or revenue) until the funds are received, others recognising a receivable when the work has been performed and others recognising a contract asset or accrued income balance with assurance practitioners having divergent views as well.

Enforceable criteria

31. In order for a revenue contract to be within the scope of AASB 15, the contract has to be enforceable, paragraphs F10 – F18 of AASB 15 provides guidance on enforceability in an NFP context, however stakeholders raised issues relating to whether refundability was sufficient to prove enforceability and whether receipt of funds without a signed contract yet being issued could be part of an enforceable contract.

32. Preparers and auditors noted instances where the only clause in relation to enforceability is a requirement to refund excess or misspent funds however there is confusion and inconsistency about whether this is enough to prove an enforceable contract since some stakeholders interpreted the standard as requiring a penalty in excess of the return of funds provided.

33. In addition, a number of NFP preparers noted that they often received funds from providers in June which related to agreements which had not been finalised or signed. The agreements include specific performance obligations for a future period, however the fund provider was required to distribute the funds prior to the end of the financial year regardless of the unsigned agreement. There is divergence in views regarding whether this implied contract would meet the criteria of an enforceable contract within the scope of AASB 15, whether a financial liability should be recorded in accordance with AASB 9 or whether the funds should be recognised on receipt under AASB 1058.

Documentation

34. Appendix F of AASB 15 requires the existence of an enforceable contract with sufficiently specific performance obligations in order to fall into its scope of AASB 15.

35. In many cases, the grant agreement only forms one part of the 'contract' and there are significant other documents in place which could assist in determining the relevant accounting standard, for example proposal documents, approved budgets. Stakeholder feedback has noted confusion around whether the other documents can and should be considered in forming opinion regarding the relevant standard which is resulting in divergence of accounting treatment.

Principal v agency - including appropriate recognition of financial liabilities.

36. AASB 15 contains specific requirement for accounting for revenue depending on whether the entity is assessed as being a principal or agent (paragraphs B34 – B38). There is no specific NFP guidance in Appendix F of AASB 15 to assist NFP entities in interpreting these paragraphs and stakeholder feedback has indicated there are a number of type of the contracts which are causing confusion and diversity of accounting for revenue on a net or gross basis and whether a financial liability should be recognised, for example:

- in some National Disability Insurance Schemes arrangements, the NFP entity receives all the funding relating to the care to be provided to a participant, however they partly act in a fund management role to distribute the funds to the relevant provider and retain funds only for the administration and disability services which they provide and

- number of consortium grants arrangements which are causing confusion as to the accounting for the lead entity.

37. The principal v agency issue has been transpired in relation to accounting for financial instruments, bequests and endowments under AASB 1058, where number of professional firms required further clarification on the analysis and accounting treatment set out in the cash scholarship endowment example in Illustrative Example 3A (IE 3A) in the standard to:

    - Provide an example with facts and circumstances where the recognition of a financial liability explicitly arises, with an explanation as to why.

    - Provide contrasting example where no recognition of financial liability arises, with explanation as to why not.

38. These stakeholders were concerned that IE 3A may lead to diversity in application of recognition of a financial liability. For example, in many case foundations that provide funding and support for other charitable organisations through grants, have charter which outlines their charitable objectives where the funding raised will be directed on 'best endeavours' basis. Question arises whether (following principles of IE 3A) the foundation should recognise a financial liability for any funding received that will be directed to other recipient and only recognise income for the portion that is retained by the foundation (e.g. to cover administration expenses).

39. In IE 3A, an endowment is made to where all income generation from the principal amount is required to be applied towards specific purpose (to be used by the recipient at their discretion). Even though entity (in this case university) selects recipients (in this case students to receive scholarship), IE 3A illustrates the accounting for the endowment under AASB 9 in accordance with paragraph 9 of AASB 1058 with any difference between the financial asset recognised (being the endowment received) and a related financial liability to be recognised under AASB 9 and part 10 of AASB 1058 does not apply.

40. If, in this case, application of AASB 1058 that is illustrated in Example 3A results in the recognition of financial liability, this may represent significant change to the current practice, where such entities are recognising income and related expense on gross basis. It was also noted that IE 3A does not clearly conclude whether any financial liability is recognised and if so, what amount should be recognised.

Termination for convenience clauses

41. In November 2020, the Board discussed the issue of termination for convenience clauses and whether the existence of these clauses in government grant agreement would result in a liability being recognised for funds received not yet spent. The majority of the board believed that the standards provided sufficient guidance on this issue and directed staff to hold further discussions with the stakeholders who had initially raised the issue and provide assistance if the stakeholders intended to submit a request to the IFRS Interpretations Committee (IFRS IC). Staff understand that the stakeholders have not yet submitted the request to IFRS IC.

42. Nevertheless, as part of the limited outreach conducted to date, staff received feedback on the continued divergence in practice. Number of preparers and auditors are of the view that

termination for convenience clauses give rise to a liability for any unspent funds where the income is within the scope of AASB 1058 which in fact allows the entities to recognise the funds as income when the related expenses are incurred, while some entities, who believe that the termination for convenience clauses is inserted only for specific purposes (e.g. change in government), are recognising revenue on receipt whereas other entities are deferring revenue recognition to match the revenue with future expenses.

Confusion about the scope of AASB 15

43. The scope of AASB 15 and AASB 1058 is different from the previous revenue standards, for example interest income and dividends are scoped out of the standards and these items are recognised in accordance with AASB 9. Some preparer stakeholders noted that they found it confusing to understand the relevant standard for non-operating revenue streams and questioned whether there was a reference document to allow them to understand the appropriate source for the accounting treatment to reduce time spent looking through multiple standards which were not applicable.

Staff recommendations and Questions to the Board

44. Staff recommend for the Board to add a short-term narrow scope project to its agenda to consider the issues identified in paragraph 10.

Question for Board members

Q1: Do Board members agree with the staff recommendations in paragraph 44?

If the Board agrees with staff recommendation:

Q2a: Are there any issues which the board do not want to consider as part of the proposed project?

Q2b: If so, does the Board wish to include these topics as part of feedback to consider in the forthcoming post-implementation review?

Next steps

45. Subject to the Board's decisions at June 2021 meeting, staff will analyse the issues to provide recommendations to the Board in relation to each of the issues raised in terms of the content and form of options available to address the issues, for example FAQ's, educational material or narrow-scope amendments to AASB 1058 or AASB 15 and will bring these recommendations to the Board's September 2021 meeting. Staff note that the scope of this proposed paper is intended to be short-term and narrow scope only and is not intended to overlap with the forthcoming PIR process.

Question for Board members

Q3: Do Board members agree with the proposed next steps?

46. Targeted feedback also identified other implementation issues listed below. Staff consider further evidence on nature and potential scope of these matters will need to be examined and considered for the purpose of AASB 1058 PIR in due course and therefore not in the scope of this project since they relate to more fundamental principles of NFP reporting in AASB 1058 and AASB 15:

- 'Sufficiently specific' criterion (AASB 15, paragraph F20 – F26) – difficulty applying the criteria may lead to inconsistencies was consistently raised by stakeholders and therefore whilst potentially some guidance may be provided in the short-term, the concept may need to be reconsidered at a more significant level;

- Legal interpretation would allow non-performance of contract claim but Australian Accounting Standards do not allow the requirements to be classified under AASB 15 – some stakeholders raised concern that the extent of specificity needed to meet the sufficiently specific criteria to be within the scope of AASB and therefore match revenue and expenses seems to be much higher threshold than a legal interpretation of whether an entity has breached the requirements of an agreement and not satisfied relevant performance obligations;
- Preparation of different accounts for management and statutory purposes – a number of preparers noted that due to the confusion caused by recognition of revenue on receipt for contracts where the entity believes there are activities to be met but the contract is not within the scope of AASB 15, their internal reporting is based on the activities of the project as this is the perceived information required by boards and most donor reporting is on this basis except for the statutory financial reporting ; and
- Matching concept – where funds are received particularly in the form of a grant, many stakeholders have noted there are certain activities that have to be performed and therefore they believe that the matching concept would provide more useful information to users and would be consistent with the requirements of AASB 120 for for-profit entities.

Question for Board members
Q4: Do Board members agree that no further work should be performed on these issues at this stage, rather they will be considered as part of the forthcoming post-implementation review?