Snapshot:

Not-for-Profit Post-implementation reviews

- Income
- Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements

Australian Government
Australian Accounting Standards Board

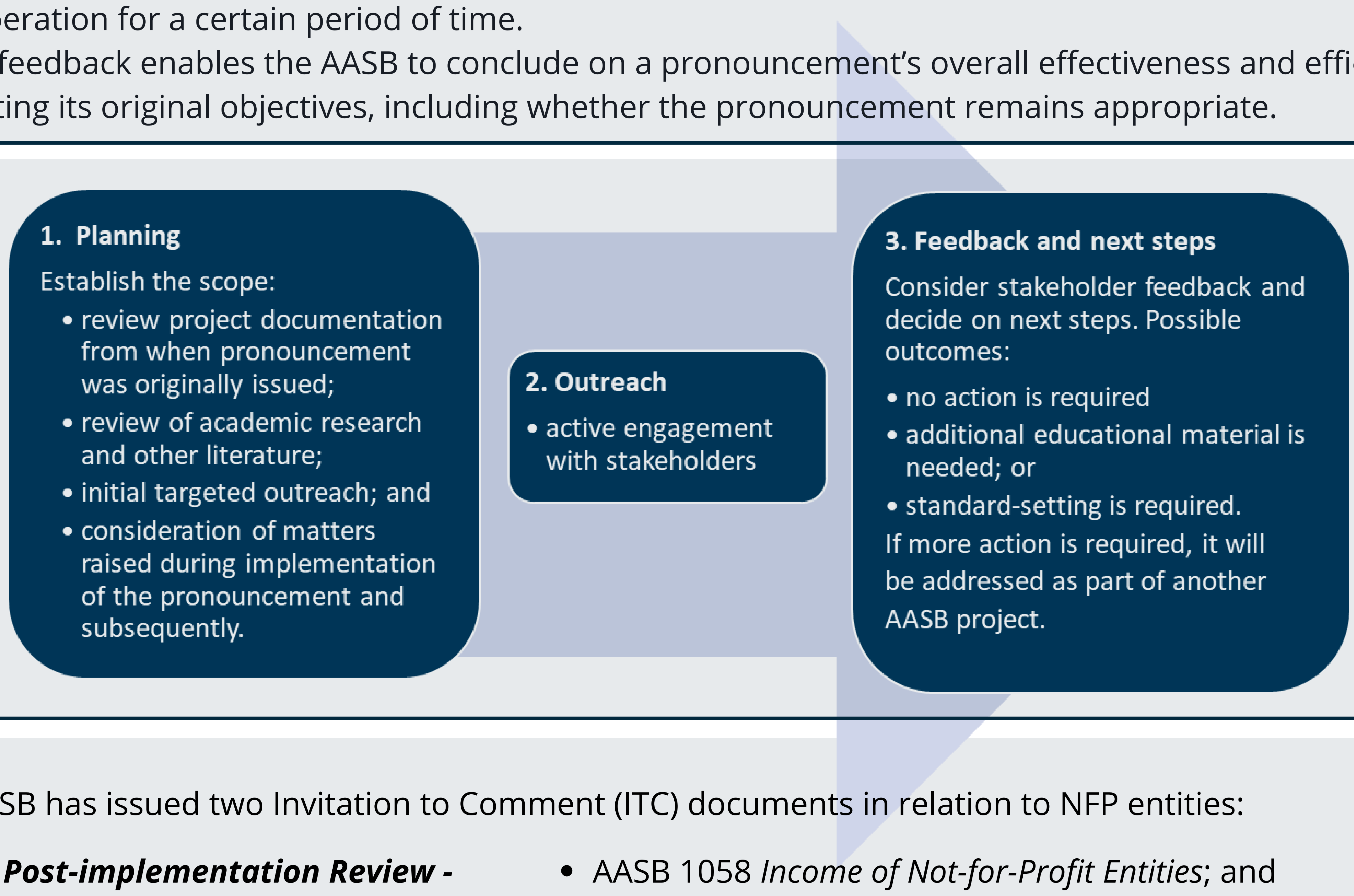
Overview

This Snapshot provides an overview of the Not-for-Profit (NFP) post-implementation reviews (PIR) and the topics.

What is a PIR?

A PIR is a process for the AASB to seek feedback from stakeholders once a new pronouncement has been in operation for a certain period of time.
This feedback enables the AASB to conclude on a pronouncement's overall effectiveness and efficiency in meeting its original objectives, including whether the pronouncement remains appropriate.

The PIR process:



What NFP requirements are open for feedback?

The AASB has issued two Invitation to Comment (ITC) documents in relation to NFP entities:

ITC 50 Post-implementation Review - Income of Not-for-Profit Entities

- AASB 1058 *Income of Not-for-Profit Entities*; and
- Appendix F of AASB 15 *Revenue from Contracts with Customers.*

ITC 51 Post-implementation Review of Not-for-Profit Topics - Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements

- Appendix E of AASB 10 *Consolidated Financial Statements;*
- Appendix E of AASB 12 *Disclosure of Interests in Other Entities;*
- AASB 124 *Related Party Disclosures* by public sector entities*;* and
- AASB 1054 *Australian Additional Disclosures* relating to Special Purpose Financial Statements.

What do we need from you?

This snapshot includes a summary of the feedback received to date on each of the NFP requirements to allow users, preparers, auditors and regulators of NFP financial statements to determine whether they have any additional feedback on the topics as well as whether they have other concerns which have not been identified.

How can feedback be provided?

- online survey
- e-mail: standard@aasb.gov.au
- formal submission: written submission by lodging online via our 'Open for Comment' page at: www.aasb.gov.au/current-projects/open-for-comment/
- Attend an outreach session:
  - Melbourne: 14 February 2023
  - Sydney: 22 February 2023
  - Roundtable virtual outreach sessions: various dates.

The AASB is seeking comments on the PIR ITCs by 31 March 2023

PIR Income of Not-for-Profit Entities

Feedback received from stakeholders to date

Topic 1:

Sufficiently specific criteria and the legal interpretation of agreements

A contract needs to have sufficiently specific performance obligations to be within the scope of AASB 15. This requires judgement and consideration of any explicit or implicit conditions in the agreement.

The AASB has received feedback that there are concerns that the comparability of NFP entity financial statements may be reduced since the term sufficiently specific:

- is unclear and there is confusion in practice, causing different accounting treatment for agreements with similar terms and conditions; and
- seems to have a higher threshold than a legal interpretation of breach of contract.

Topic 2:

Capital grants

Where an NFP entity receives funding, under an enforceable agreement, to enable it to acquire or construct a recognisable non-financial asset to identified specifications that it will control, AASB 1058 requires the entity to recognise a liability and income as it satisfies its obligations under the agreement. Such transfers are often referred to as “capital grants”.

The AASB has received feedback that because there is no guidance to explain how specific the identified specifications need to be, this is causing divergent views about how much detail is required and therefore inconsistent accounting treatment for similar contracts.

Topic 3:

Differences between management accounts and statutory accounts and alternative revenue recognition models

In some cases, entities are required by the accounting standards to recognise income on receipt, whilst expenses are recognised when incurred, which could be in a subsequent reporting period or periods.

The AASB has received feedback that recognising income on receipt can be unhelpful for users of financial statements because activities still need to be performed.

Many stakeholders noted that internal finance reports are being prepared based on the activities of the project, rather than the accounting standards, because they are more useful.

Topic 4:

Principal v agent, including the appropriate recognition of financial liabilities

Whether an entity is a principal or an agent affects the accounting for any funds received:

- a principal (i.e. an entity that provides goods or services) recognises the gross amount paid by the customer as revenue and payments made to provide the goods or services are recorded as expenses as incurred; however
- an agent (i.e. an entity whose role is to arrange for another party to provide the goods or services) recognises a financial liability for funds received that will be passed on to the recipient and only recognises revenue for the amount they will retain (e.g. for administrative expenses).

The AASB has received feedback that indicates further clarification is needed regarding the accounting treatment of financial instruments under AASB 1058, particularly whether to recognise a financial liability (and the amount) when an entity’s only obligation is to transfer funds received to other entities.

Stakeholders have expressed concerns that the existing illustrative examples in AASB 1058 may lead to diversity in recognising financial liabilities.

PIR Income of Not-for-Profit Entities

Feedback received from stakeholders to date

Topic 5:

Grants received in arrears

AASB 1058 requires an entity to consider whether an asset should be recognised and how it is measured. This is dependent on its nature and may include a:

- financial asset, when the entity has a contractual right to receive cash or another financial asset from the grantor; or
- another type of asset in accordance with another standard (AASB 16 *Leases*, AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets*) when it is not a financial asset.

The AASB has received feedback indicating there are divergent views on how to account for grants received in arrears, particularly where some of the work funded by the grant is performed before the funding is received.

For example, in December 20X1 an entity is awarded funding in relation to community engagement sessions under an enforceable agreement. The agreement is not considered sufficiently specific however the entity is entitled to $100 for each session held up to $100,000. The entity claims payment every six months and from January to June 20X2, the entity has held five hundred sessions. The different approaches applying in practice are:

(a) not recognise an asset (or revenue) until funds are received;
(b) recognise a receivable (and revenue) when the sessions are held; or
(c) recognise a contract asset (and revenue) when the sessions are held.

Topic 6:

Termination for convenience (TFC) clauses

A TFC clause allows one or both parties to terminate the agreement without showing cause and are commonly used in government grants.

The AASB has received feedback that indicates diversity in practice with two views relating to the recognition of liabilities for unspent funds where a TFC clause is present:

- View (a) – recognise a liability for unspent funds when the grant is provided, and income is recognised as the funds are spent; or
- View (b) – a liability is recognised only when the TFC clause has been exercised and there has been a request for repayment. Income is recognised on receipt of the grant.

Topic 7:

Accounting for research grants

Accounting for research grants depends on the specific terms and conditions of the grant. Revenue is recognised over time when the customer simultaneously receives and consumes the benefit provided by the entity's performance.

In 2019, the AASB issued additional guidance on the accounting for research grants by adding illustrative examples 4A and 4B in AASB 15 and issuing AASB Staff FAQs to clarify the application of recognising revenue over time.

The AASB has received feedback that notwithstanding the additional guidance, there continues to be differences in application regarding the revenue recognition of research grants.

Topic 8:

Statutory receivables

A statutory receivable is one which arises from statutory requirements rather than through a contract, for example rates, taxes and fines. As the nature of statutory receivables is similar in nature to a contractual receivable, statutory receivables are recognised and measured as if they are financial assets when statutory requirements establish a right for the entity to receive cash or another financial asset.

The AASB has received feedback that suggests:

- the requirements to recognise and measure a statutory receivable as if it were a financial asset only applies to initial measurement and not subsequent measurement, causing inappropriate inconsistency across entities in the subsequent measurement of such assets; and
- initial measurement of the statutory receivable at fair value has also added considerably to the workload of preparers and auditors.

PIR of Not-for-Profit Topics - Control, Structured Entities, Related Party Disclosures and Special Purpose Financial Statements

Feedback received from stakeholders to date

Topic 1 : Control and consolidation for NFP entities

Application of the control model in the NFP sector

The AASB added Appendix E to AASB 10 in 2013 to provide guidance on how the control definition in AASB 10 applies to NFP entities, including criteria for determining whether one entity controls another entity.

The AASB has received feedback that indicates concerns about applying the control model in the NFP sector, in particular:

- NFP entities being required to consolidate other entities they do not believe they have genuine control over – particularly where there are no shared financial liabilities or other financial impacts of the relationship;
- that consolidated financial statements may not be appropriate since the parent's financial position and performance may be obscured by the subsidiary, although the parent might not be able to access the net assets or funds of the subsidiary; and
- consolidation may be difficult due to practices in the sector, for example, secrecy and lack of documentation, which makes it difficult for the entity to obtain the required information from the controlled entity.

Identifying variable returns in the NFP sector

AASB 10 Appendix E includes guidance relating to the broad nature of variable returns, specifically that returns may be financial, non-financial, direct and indirect benefits and returns may also be positive or negative.

The AASB has received feedback that indicates there are challenges identifying variable returns since the implementation guidance in Appendix E is too broad and most returns in the NFP sector are non-financial.

Customary business practices in the NFP sector

The AASB has received feedback suggesting it is unclear what effect customary business practices have on assessing control in the NFP sector.

For example, if an Association has established a customary business practice by only distributing returns to a particular entity, does this expose the entity to variable returns regardless of the fact that the rules of the Association permit returns to be distributed to any entity the Association considers worthy?

Assessing control without an equity interest

The AASB has received feedback that indicates assessing whether an NFP entity has rights that give rise to power can be challenging due to the legal structure of some entities.

There are questions about whether the ability to direct distributions on winding up an entity gives rise to power and an exposure to variable returns. AASB 10 Appendix E suggests this may be a protective right rather than a substantive right.

In practice, the AASB understands that when surplus assets are distributed back to the investor, investors often conclude they have control. Alternatively, when surplus assets are distributed to an unrelated entity, determining whether the investor has control is less clear.

Principal v agent - public sector entities

Stakeholders have sought clarification of when an NFP public sector entity might be acting as a principal or an agent. In the public sector, investments are often not financial, and returns are often in the form of policy outcomes rather than financial outcomes.

The AASB has received feedback suggesting there can be inconsistent conclusions in similar situations. Further, existing guidance in AASB 10 Appendix E is generally useful as it clarifies/confirms how to analogise the requirements for the public sector. However, in some cases, it is necessary to apply the for-profit guidance that applies to managed funds.

PIR of Not-for-Profit Topics - Control, Structured Entities, Related Party Disclosures and Special Purpose Financial Statements

Feedback received from stakeholders to date

Topic 2: The definition of a structured entity for NFP entities

The AASB added Appendix E to AASB 12 in 2013 which explains the application of the definition of structured entity by NFP entities to clarify that the definition is intended to capture entities where less conventional means – in the context of NFP entities (e.g. administrative arrangements and statutory provisions) – are the dominant factors in determining who controls the entity.

The AASB is not aware of any implementation issues arising from the application of AASB 12 Appendix E.

Topic 3:

Related party disclosures by NFP public sector entities

AASB 124 requires NFP public sector entities to disclose related party relationships, transactions and outstanding commitments in its financial statements.

The AASB has received feedback relating to:

(a) a public sector entity's ability to obtain the information necessary to prepare the required disclosures, including:
  - (i) challenges identifying a complete set of related parties;
  - (ii) difficulties in ensuring the completeness of representations made by related parties completing documentation about their engagements with the entity and requiring the completion and return of such forms; and
  - (iii) the extent of information related parties were required to provide was partly because of the close family member provisions of the Standard.

(b) data privacy;

(c) the auditability of disclosures;

(d) the appropriateness and value of the requirements in relation to the apparent capture of wide net of people and entities; and

(e) how the concept of materiality applies to transactions with related party key management personnel. Although the AASB did not see a need to amend AASB 124 in respect of this issue, when the AASB issued Practice Statement 2 *Making Materiality Judgements* in 2017, it added Appendix A *Materiality of key management personnel related party transactions of not-for- profit public sector entities* to the practice statement.

Topic 4:

Basis of preparation of special purpose financial statements (SPFS): Disclosures about compliance with Australian Accounting Standards

NFP entities applying AASB 1054 and preparing SPFS are required to disclose information, including the extent of their compliance or otherwise with the recognition and measurement requirements of Australian Accounting Standards. Entities are also required to disclose the extent of their compliance with the consolidation and equity accounting requirements in Australian Accounting Standards where they have identified interests in subsidiaries, associates and joint ventures.

Feedback indicates this disclosure provides important information from a user perspective.

The AASB is not aware of any implementation issues arising from these disclosures. It is acknowledged disclosures are only required to be made by part of the NFP population.