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October 2017
A&A Accounting Technical

Clarity *in financial reporting*

AASB's new income recognition requirements for not-for-profit entities

Talking Points

- In December 2016, the AASB published new income recognition requirements for not-for-profit (NFP) entities detailed below:
  - AASB 1058 *Income of Not-for-Profit Entities*
  - AASB 2016-7 *Amendments to Australian Accounting Standards - Deferral of AASB 15 for Not-for-Profit Entities*
  - AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities [AASB 9 & AASB 15]*

  It supersedes the current income recognition requirements contained in AASB 1004 *Contributions*, AASB 118 *Revenue* and AASB 111 *Construction Contracts*.

- The new income recognition requirements shift the focus from a reciprocal/non-reciprocal basis to a basis of assessment that considers the enforceability of a contract and the specificity of performance obligations.

- The core principle of the new income recognition requirements in AASB 1058 is when a NFP entity enters into transactions where the consideration to acquire an asset is significantly less than the fair value of the asset principally to enable the entity to further its objectives, the excess of the asset recognised (at fair value) over any 'related amounts' is recognised as income immediately.

- An example of a 'related amount' is AASB 15 and in cases where there is an 'enforceable' contract with a customer with 'sufficiently specific' performance obligations, income is recognised when (or as) the performance obligations are satisfied under AASB 15, as opposed to immediate income recognition under AASB 1058.

- The new income recognition requirements introduce far more prescriptive guidance than is included in current requirements and the majority of NFP entities are likely to be affected by this. Furthermore, the new income recognition requirements may result in substantial changes to the timing and amount of income recognition for some NFP entities arising from increased opportunities for income deferral.

- The new income recognition requirements are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted provided entities adopt both AASB 1058 and AASB 15 to the same period. NFP entities can choose to apply AASB 1058 retrospectively or to use a modified transition approach.

1. Introduction

In April 2015, the AASB issued ED 260 *Income of Not-for-Profit Entities* which proposed requirements for the recognition, measurement and disclosure of income of Australian NFP entities in the public and private sectors. The comment deadline closed on 14 August 2015 and the AASB spent a further year redeliberating on the project. On 28 September 2016, the AASB issued the fatal flaw drafts which were open for comment until 21 October 2016.

On 20 December 2016, the AASB published new income recognition requirements for NFP entities detailed in the following:

- AASB 1058 *Income of Not-for-Profit Entities*
- AASB 2016-7 *Amendments to Australian Accounting Standards - Deferral of AASB 15 for Not-for-Profit Entities*
- AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities [AASB 9 & AASB 15]*

The AASB has also issued accompanying extensive application guidance and a wide range of illustrative examples to assist NFP entities in applying these new requirements.

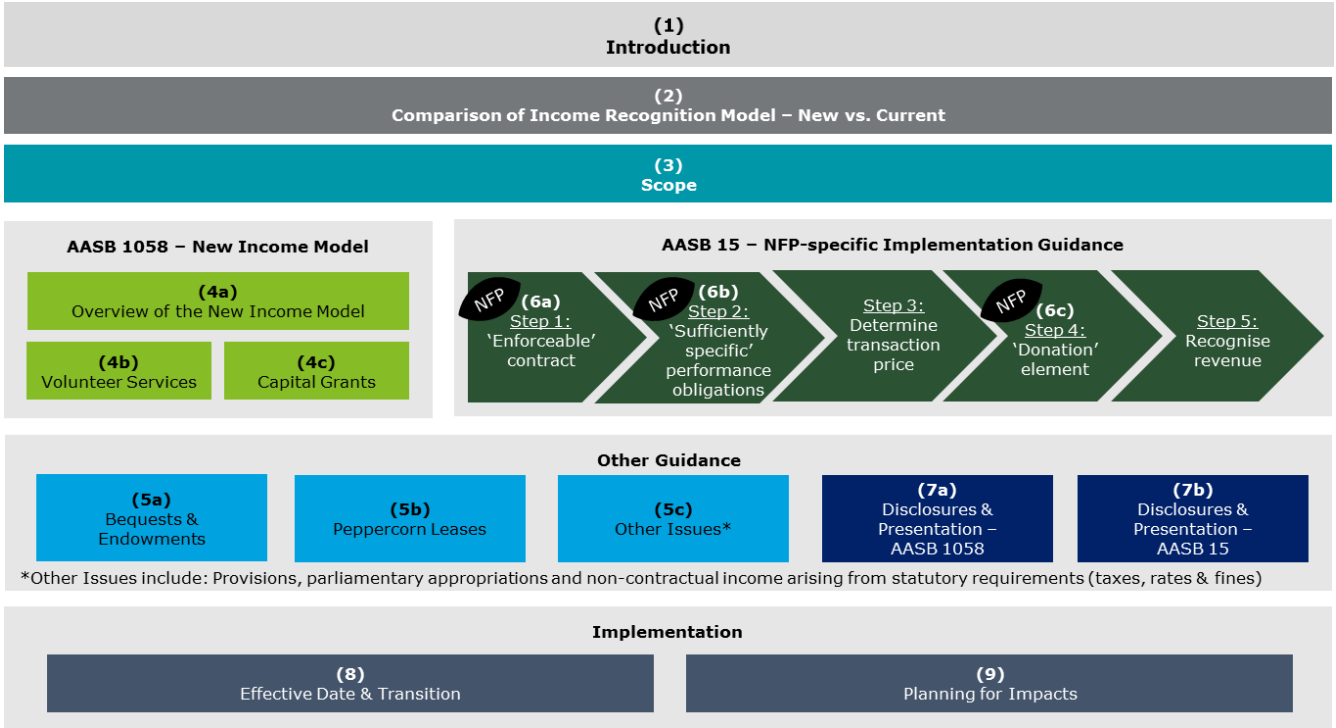
The new income recognition requirements represent a major step taken by the AASB towards financial reporting that aims to better meet the needs of NFP entities and the users of their reports by more closely reflecting the economic reality with increased opportunities for income deferral. The new income recognition requirements represent significant developments from ED 260 with the timing of income recognition being dependent on whether a transaction gives rise to a liability or other performance obligation (a promise to transfer a good or service) related to an asset (such as cash or another asset) controlled by an entity.

The new income recognition requirements are applicable to all NFP entities in the public and private sectors. They supersede the current income recognition requirements contained in AASB 1004 *Contributions*, AASB 118 *Revenue* and AASB 111 *Construction Contracts*. For public sector NFP entities, AASB 1004 continues to apply for the accounting of parliamentary appropriations, restructures of administrative arrangements and contributions by owners.

1a. Publication overview

This publication provides an overview of the new income recognition requirements, including a discussion of the key elements of the new income model of AASB 1058 and NFP-specific guidance in AASB 15, relevant application guidance and the areas that may result in a change in practice. In many cases, there will be complexities within each transaction which will need to be assessed and interpreted in detail on a case by case basis. Furthermore, some of the information included in this publication is based on our preliminary observations and may be subject to change as issues from the implementation of the new guidance arise and as practice develops.

The following diagram highlights the structure of the new income recognition requirements and references to commentary in the corresponding sections in this publication. Within each section, this publication includes an overview of the new requirements, our observations and comparison with current requirements.



2. Comparison of income recognition model – New vs. Current

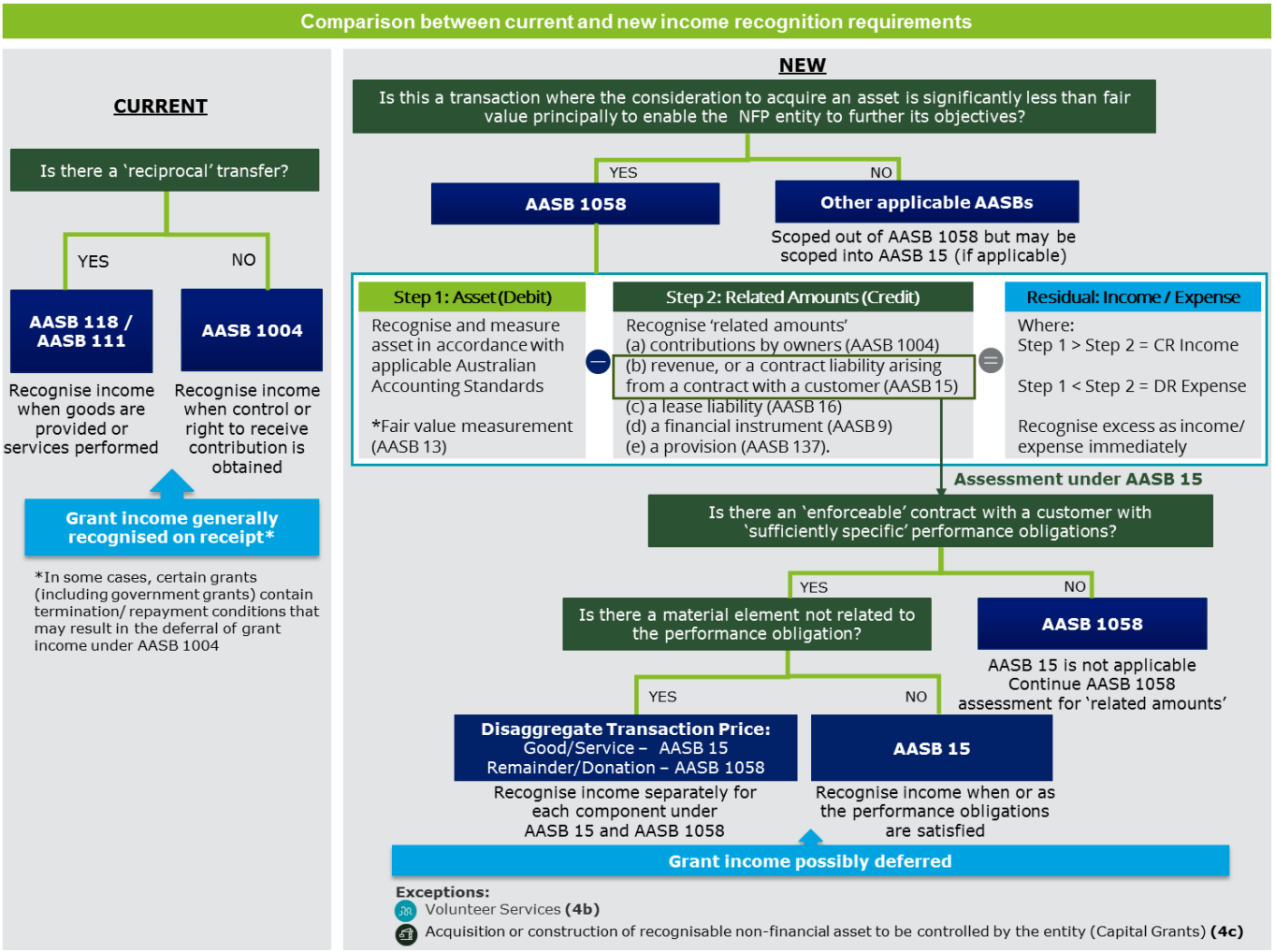
Under the current income recognition requirements, when a NFP entity receives assets or services or has liabilities extinguished, it is required to assess if this should be treated as a 'contribution' under AASB 1004. If the transfer is 'non-reciprocal', meaning that it is a transfer in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer, this would be accounted for as a 'contribution' under AASB 1004 (where income is recognised when control or the right to receive a contribution is obtained). Otherwise, for reciprocal transfers, the NFP entity would refer back to AASB 118 or AASB 111 and would recognise income when goods are provided and services are performed.

The new income recognition requirements shift the focus from a reciprocal/non-reciprocal basis to a basis of assessment that considers the existence and enforceability of a contract and the specificity of any performance obligations.

The core principle of the new income recognition requirements is that, where there is an 'enforceable' contract with a customer with 'sufficiently specific' performance obligations, income would be recognised when (or as) the performance obligations are satisfied under AASB 15. Entities should ensure that the criteria in paragraph 9 of AASB 15 have been met in order for a contract with a customer to be accounted for in accordance with AASB 15.

Should the transaction fall outside of the scope of AASB 15, then income (being the residual amount determined by the initial carrying amount of the asset and 'related amounts' recognised) would be recognised immediately under AASB 1058.

As the new income recognition requirements provide increased opportunities for income deferral, as compared to AASB 1004, this may result in substantial changes to the timing and amount of income recognition for certain NFP entities when accounting for grants. This is illustrated in the diagram below.



3. Scope

For a transaction that arises from a contract with a customer and is consequently accounted for under AASB 15, further information regarding the scope of AASB 15 is discussed in section 6 of this paper. This section discusses the issues to consider when assessing if a transaction should be accounted for under AASB 1058.

AASB 1058 prescribes the income recognition requirements for:

- transactions where the consideration to acquire an asset is significantly less than the fair value of the asset principally to enable the NFP entity to further its objectives (including transfers to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity); and
- volunteer services received by NFP entities.

Examples of transactions where the consideration provided to acquire an asset is significantly less than the fair value of the asset principally to enable the NFP entity to further its objectives are:

- cash and other assets received from grants, bequests or donations;
- receipts of appropriations by government departments and other public sector entities;
- receipts of taxes, rates or fines; and
- assets purchased for nominal or low values.

Where an asset is acquired for consideration that is significantly less than fair value but that difference is not principally related to furthering the entity's objectives, the transaction is not within the scope of this Standard. Examples of such transactions include assets acquired in distress sales and trade discounts.

Volunteer services are services transferred by individuals or other entities without charge or for consideration significantly less than the fair value of those services. For example, NFP entities may be recipients of volunteer services under voluntary or compulsory schemes operated in the public interest (e.g. hospitals receiving the services of volunteers or technical assistance from other governments or international organisations) and some NFP entities may also be recipients of volunteer professional services that support their broader activities (e.g. charities and religious organisations may receive free professional accounting or legal services).

Observations

For a transaction to fall within the scope of AASB 1058 (excluding volunteer services), it needs to meet both of the following:

- the consideration to acquire an asset is required to be 'significantly' less than the fair value of the asset; and
- the difference is principally to enable the NFP entity to further its objectives

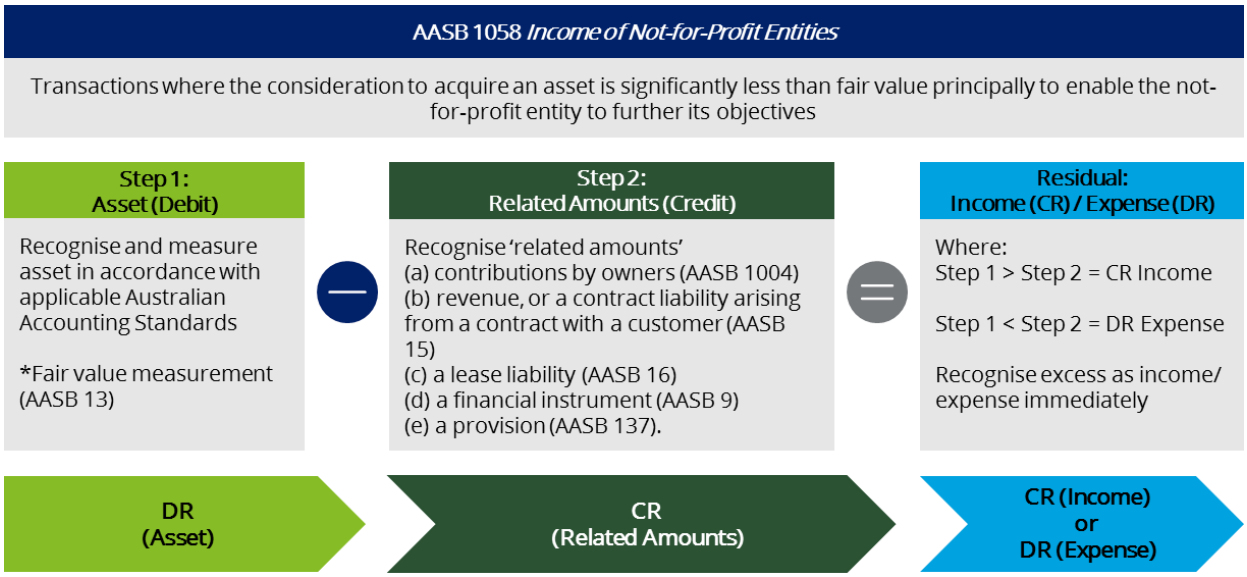
The Basis for Conclusions accompanying AASB 1058 states that the AASB's intention is to ensure that transactions where the consideration is only marginally less than fair value are not expressly covered in AASB 1058. As AASB 1058 does not provide a quantitative threshold for a difference to be considered 'significantly' less than fair value, the determination of what constitutes 'significantly' less than fair value will require the application of judgement. We recommend entities establish an accounting policy for the determination of 'significantly' less than fair value.

When assessing whether the difference is principally to enable the NFP entity to further its objectives, the entity may consider whether another entity could have obtained the asset under the same terms and conditions. If those terms and conditions are generally not available to other entities of the same class/nature, it is more likely that the difference between the consideration for the asset and the fair value of the asset acquired is principally for enabling the entity to further its objectives.

4. AASB 1058 Income of Not-for-Profit Entities – New Income Model

4a. Overview of the new model

A core principle of the new income recognition requirements in AASB 1058 is that when a NFP entity enters into transactions where the consideration to acquire an asset is significantly less than the fair value of the asset principally to enable the entity to further its objectives, the excess of the asset recognised (at fair value) over any other financial statement elements ('related amounts'), recognised in accordance with the applicable Australian Accounting Standard, is recognised as income.
This is illustrated in the diagram below:



Where a NFP entity enters into transactions where the consideration to acquire an asset is significantly less than the fair value of the asset principally to enable the entity to further its objectives (i.e. other than trade discounts and distress sales), the transaction will fall within the scope of AASB 1058, which requires the asset to be fair valued in accordance with AASB 13 *Fair Value Measurement*. This marks a significant change for NFP entities as current requirements only require fair value measurement of assets acquired by NFP entities at nil or nominal consideration.

Upon initial recognition of the asset (measured at fair value), this Standard requires the entity to consider whether any other financial statement elements should be recognised ('related amounts') in accordance with the relevant applicable Australian Accounting Standard including:

a) contributions by owners (AASB 1004);
b) revenue, or a contract liability arising from a contract with a customer (AASB 15);
c) a lease liability (AASB 16 *Leases*);
d) a financial instrument (AASB 9 *Financial Instruments*); or
e) a provision (AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*).

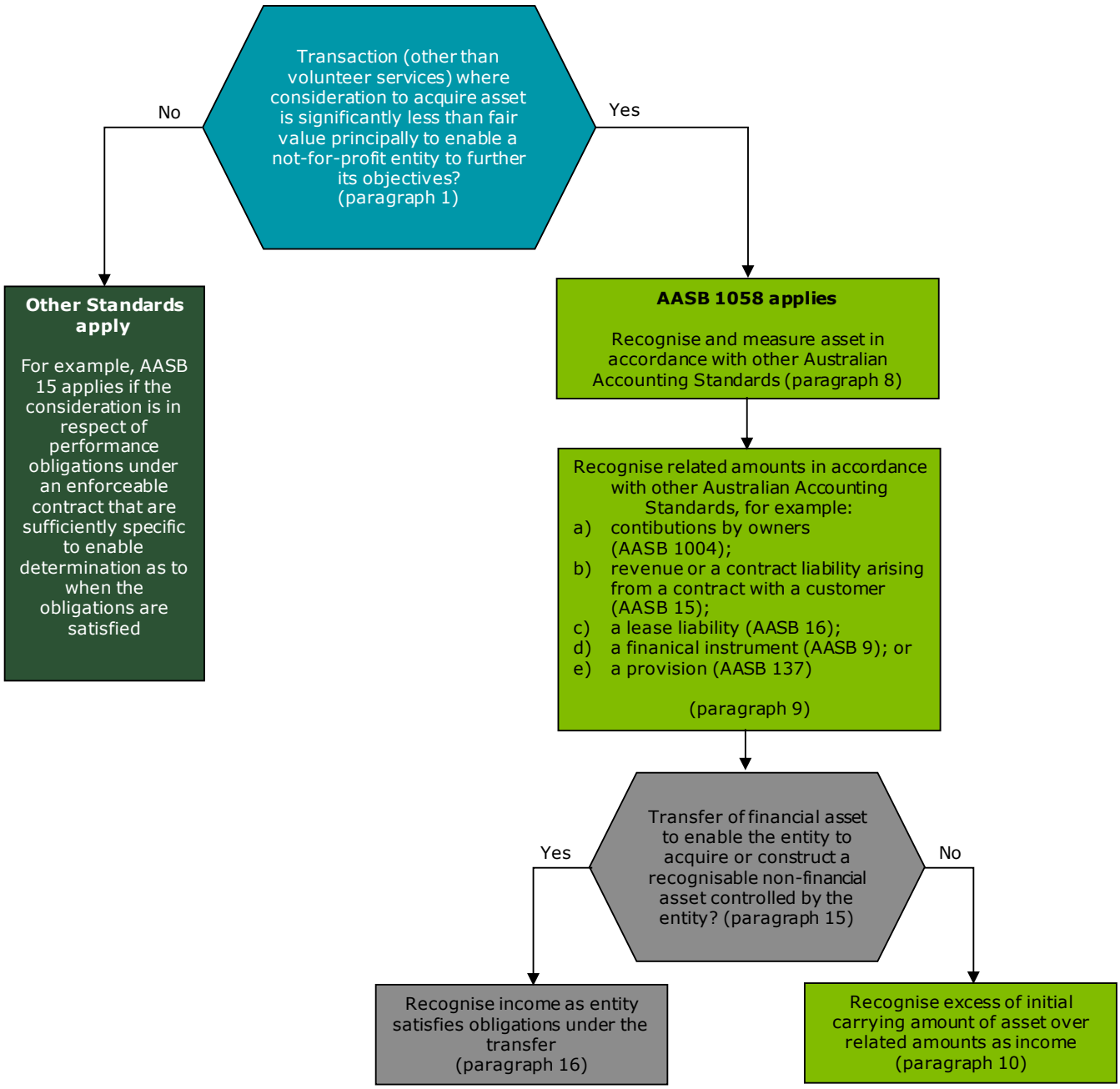
Any excess of the fair value of the asset over any related amounts recognised will be recognised as income.

In addition to the general income recognition requirements detailed above, AASB 1058 contains specific income recognition requirements for volunteer services and transfers to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity (commonly known as 'capital grants') which are discussed in sections 4b and 4c.

In cases where the transaction falls within the scope of AASB 15 (i.e. enforceable contract with a customer with sufficiently specific performance obligations), the AASB has issued additional NFP-specific implementation guidance in AASB 15. This is discussed in detail in section 6.

The flowchart below illustrates the application of AASB 1058, excluding volunteer services which are discussed in the next section.

Chart 1 - Transactions other than Volunteer Services



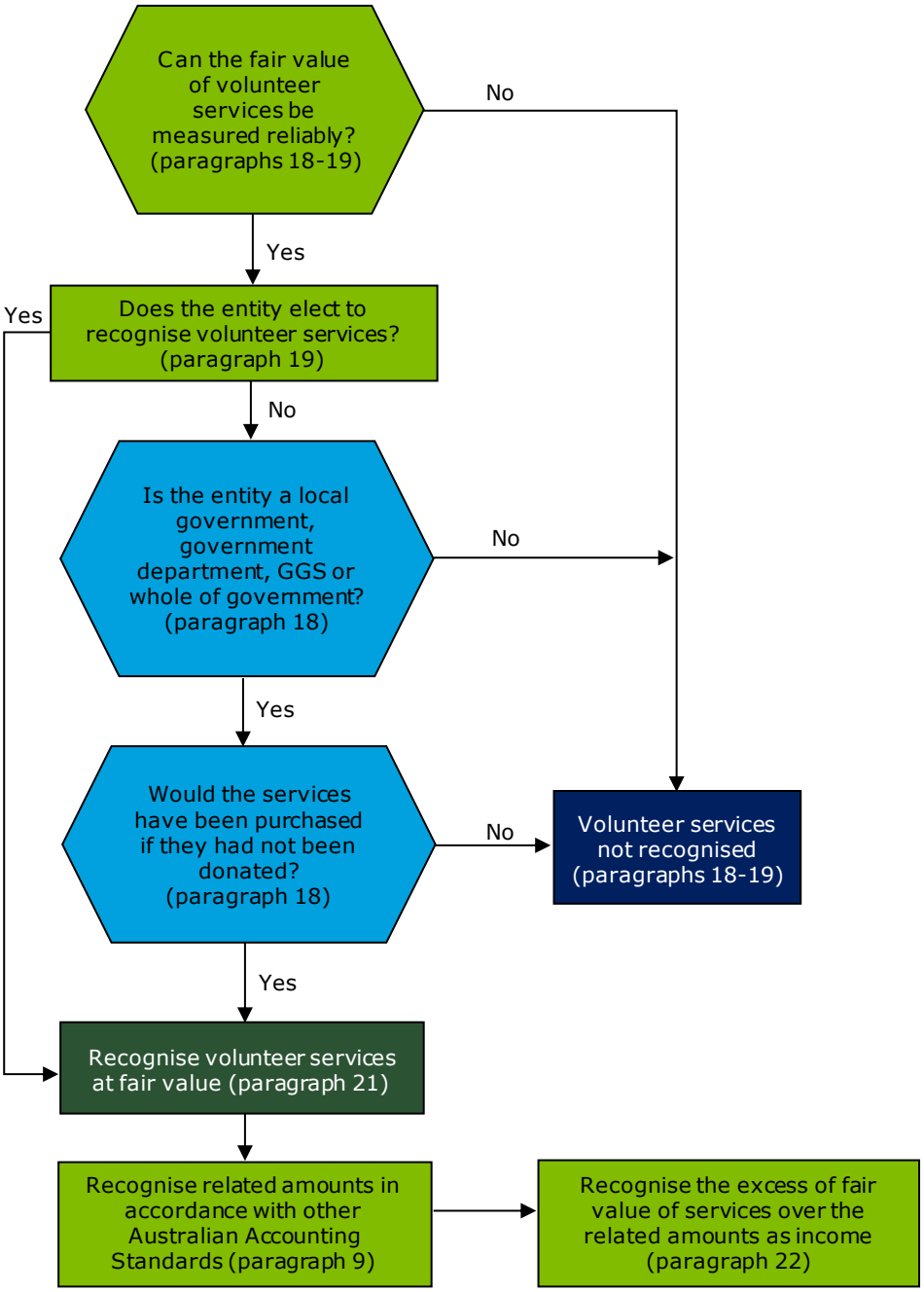
4b. Volunteer services

Under the current requirements, AASB 1004 requires local governments, government departments, general government sectors and whole of governments to recognise volunteer services as income at fair value if the fair value of those services can be measured reliably and the services would have been purchased if they had not been donated. In contrast, in respect to private sector NFP entities, AASB 1004 is silent as to whether these entities should recognise the value of volunteer services.

The requirements have carried forward in AASB 1058 in respect of the public sector requirements, virtually unamended, where local governments, government departments, general government sectors (GGSs) and whole of governments are required to recognise volunteer services if they would have been purchased if not received voluntarily and the fair value of those services can be measured reliably.

As a change from AASB 1004, private sector NFP entities will now have a policy option to account for donated services at fair value if the fair value can be reliably measured.

The flowchart below illustrates the accounting for volunteer services.



Observations
The accounting for volunteer services involves minimal changes for both the public and private sector entities. The only key difference is that the AASB now encourages disclosure of qualitative information about the nature of the entity's dependence arising from volunteer services it receives, including those not recognised.

As private sector NFP entities have the option to recognise volunteer services (unlike public sector entities which require mandatory recognition), it is important to note that if an entity choses to recognise volunteer services, this is an accounting policy choice and once adopted, it can only change its accounting policy if the change meets the criteria in AASB 108.

4c. Acquire or construct a recognisable non-financial asset to be controlled by the entity (Capital grants)

In cases where the transaction includes a transfer to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity, AASB 1058 requires the entity to recognise a liability for the excess of the fair value of the transfer over any related amounts recognised and recognises income as it satisfies its obligations under the transfer.

Under AASB 1058.15-17, a transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset for its own use is one that:

- requires the entity to use that financial asset to acquire or construct a non-financial asset to identified specifications;
- does not require the entity to transfer the non-financial asset to the transferor or other parties; and
- occurs under an enforceable agreement.

For such transactions, an entity shall recognise a liability for the excess of the initial carrying amount of a financial asset received over any related amounts recognised. The entity shall recognise income in profit or loss when (or as) the entity satisfies its obligations under the transfer, which is when it constructs or acquires the asset.

For each obligation, the entity needs to determine whether the obligation would be satisfied over time or at a point in time. If an entity does not satisfy an obligation over time, the obligation would be satisfied at a point in time. For an obligation that is satisfied over time (not at a point in time), an entity is required to remeasure its progress towards complete satisfaction of the obligation at the end of each reporting period.

An entity shall apply the requirements of AASB 9 when accounting for the financial asset (e.g. cash) received. The acquisition or construction of the non-financial asset is accounted for separately to the transfer of the financial asset, in accordance with other Standards.

The above accounting only applies for transfers that meet the criteria to be considered as 'transfers to enable an entity to acquire or construct a recognisable non-financial asset to be controlled by the entity'. A key criterion is that the non-financial asset to be constructed or acquired by the entity needs to be permitted to be recognised by another Standard (e.g. the construction of a building under AASB 116 or development expenditure under AASB 138). If the non-financial asset is not permitted to be recognised by another Standard (e.g. research activities which cannot be recognised as an asset in accordance with AASB 138), the entity is not permitted to apply the capital grant accounting as discussed in AASB 1058.15-17. Instead, the entity would revert back to the general income recognition requirements under AASB 1058.9 – which is to recognise the difference between the initial carrying amount of the asset and any 'related amounts' immediately.

Observations
The guidance in respect of income recognition requirements for capital grants is far more prescriptive than was included in AASB 1004.

Entities will first need to assess if the capital grants meet the criteria to be accounted for under the specific capital grant accounting in AASB 1058.15-17. If so, they will need to account for the obligation to acquire or construct the non-financial asset similarly to a performance obligation under AASB 15. This will require analysing arrangements at a level not previously required under AASB 1004.

As mentioned above, AASB 1058.15-17 capital grant accounting only applies when the non-financial asset to be constructed or acquired by the entity is permitted to be recognised by another Standard. This would mean that for capital grants relating to a recognisable asset, a liability would need to be recognised and income would be subsequently recognised either at a point in time (commonly for acquisition grants) or over time (commonly for construction grants).

For capital grants relating to a non-recognisable asset (e.g. research grants not permitted to be recognised as an asset under AASB 138), entities would revert back to the general income recognition requirements under AASB 1058.9 which requires entities to recognise income immediately for the excess of the initial carrying amount of the asset over any 'related amounts'.

It is important to note that when making the assessment of 'related amounts' under AASB 1058.9 for unrecognisable asset capital grants, the non-financial asset must be under the control of the entity (i.e. for its own use) – it will not be transferred to the transferor or other parties. Therefore, the transfer of the financial asset (or the relevant part) to the entity does not occur under a contract with a customer and is not subject to AASB 15. Accordingly, the accounting for capital grants for an unrecognisable asset would commonly result in upfront income recognition, despite the fact that the development of the non-financial asset might be performed over an extended period.

5. AASB 1058 Income of Not-for-Profit Entities – Application guidance

To assist NFP entities in applying the new income recognition requirements, AASB 1058 includes application guidance on specific topics, some of which differs from the current accounting requirements. The Standard covers the recognition and measurement of bequests, endowments, provisions, parliamentary appropriations and non-contractual income arising from statutory requirements (i.e. taxes, rates and fines). In particular, the guidance on bequests and endowments is considered relatively complex and is discussed in section 5a immediately below.

Furthermore, another area which signifies a major change from current practice are the new accounting requirements introduced for leases at significantly below-market terms and conditions, which are also known as "peppercorn leases". This is discussed in section 5b below.

5a. Bequests and endowments

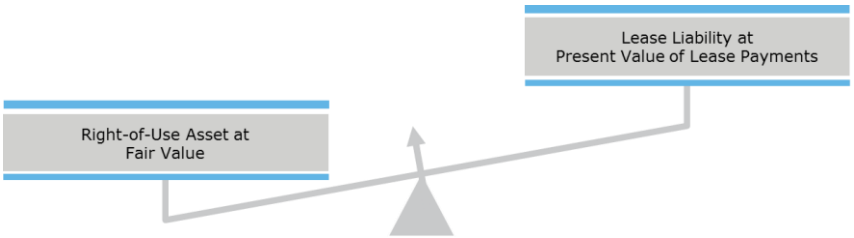
When accounting for bequests, the assessment of whether the initial recognition of bequeathed items as assets in accordance with another Standard simultaneously gives rise to the recognition of income will depend on whether the entity recognises a liability, or other related amounts, as a result of the bequest. For example, the terms of a bequest may establish a contract between an entity and the estate that falls within the scope of AASB 15 and therefore, gives rise to a contract liability.

Endowments may be made for the perpetual benefit of the entity in that the transfer is made with a requirement for the principal to be preserved, and only the income earned on investment activity is available for use in furthering the entity's objectives. Furthermore, an endowment may include conditions pertaining to investment of the principal and the purpose to which investment income must be applied. For example, an endowment made to a university may be made on condition that the principal is invested and the investment income used to fund an annual scholarship. In such cases, an entity shall consider whether the conditions of the transfer give rise to any related contribution by owners, liabilities or revenue that is recognised at the same time as the entity recognises an asset. For example, an entity may determine the conditions give rise to a financial liability within the scope of AASB 9 for the obligation to provide a financial asset into the future (e.g. cash scholarships), or a contract liability within the scope of AASB 15 for unperformed performance obligations relating to the transfer of goods or services under the terms of the endowment (e.g. sufficiently specific performance obligation to provide annual scholarships for one student's accommodation for a defined period of 30 years).

5b. Leases at significantly below-market terms and conditions (Peppercorn leases)

Under current requirements, if a NFP entity is granted a below-market lease that is classified as a finance lease, AASB 117 requires the NFP entity to measure the lease asset and liability at the present value of the minimum lease payments. This effectively understates the lease asset and fails to recognise the donation component.

To address this, AASB 1058 has introduced new income recognition requirements for NFP entities with leases at significantly below market terms and conditions to enable it to further its objectives (commonly known as 'peppercorn leases') – it requires the measurement of the right-of-use asset at fair value in accordance with AASB 13 and the lease liability to be measured in accordance with AASB 16 (being the 'related amount' per AASB 1058.9 given that the lease liability arises from a lease contract within the scope of AASB 16) with the difference between the fair value of the lease asset and present value of the peppercorn lease rental generally be accounted for as income in accordance with AASB 1058. In cases where there are other sufficiently specific performance obligations requiring transfers of goods or services to the lessor or others associated with the lease contract (e.g. required usage of the facility to provide specified services/outcomes), this may result in the recognition of a 'related amount' arising from a contract with a customer in accordance with AASB 15, in addition to the 'related amount' recognised for the lease liability in accordance with AASB 16.



Observations

The accounting for leases transacted at significantly below-market terms and conditions is one of the key changes in current practice which may see the affected NFP entities recording a significant amount of income upfront at the inception of the lease.

NFP entities will need to reassess their lease contracts and where relevant, obtain valuations in order to measure the lease asset at the fair value of the leased property at inception of the lease, which was previously not required.

It is also important to note that leases at significantly below-market terms and conditions have specific transition requirements which differ from the general transition requirements of AASB 1058. This is discussed in detail in section 8c of this publication.

5c. Other issues

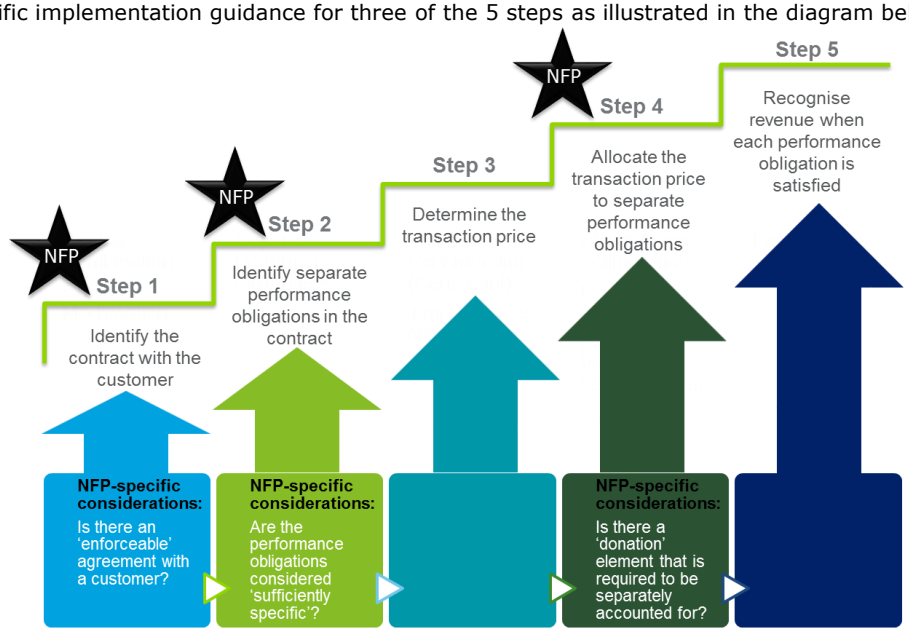
Guidance is also included in AASB 1058 for the following topics:

- **Provisions** – When applying the requirements of AASB 1058 on the recognition of 'related amounts', entities should assess if a provision should be recognised in accordance with AASB 137 for a constructive obligation or a legal obligation. When assessing if there is a constructive obligation, entities must demonstrate that the published policies, past practices or current statements are sufficiently specific to raise a valid expectation on the part of other parties that the entity will discharge its responsibilities under those policies, practices or statements. Entities should also look to the contractual terms (implicit or explicit), legislation or another operation of the law to determine if a legal obligation exists.
- **Parliamentary appropriations** – As the nature of parliamentary appropriations can vary across different jurisdictions and for different types of appropriations, entities should note that the extent to which amounts appropriated for a government department's use are recognised as income of a particular reporting period are determined by reference to the characteristics of the appropriation process and the circumstances in which the government department recognises appropriated amounts. For example, for some government departments that do not gain control of funds appropriated for their use until obligations are incurred or expenditures are made, appropriations recognised as income are in the nature of a recovery of costs incurred for the acquisition of goods and services or for amounts otherwise expended.
- **Non-contractual income arising from statutory requirements** (i.e. taxes, rates and fines) – Taxes, rates and fines do not give rise to a contract liability or revenue recognised in accordance with AASB 15, even when they are raised in respect of specific goods or services. This is because the entity does not promise to provide goods or services in an agreement that creates obligations enforceable against the entity by legal or equivalent means.

6. AASB 15 NFP-specific implementation guidance

In cases where there is an 'enforceable' contract with a customer with 'sufficiently specific' performance obligations, the transaction or the attributable amount of the asset should be accounted for under AASB 15. If the promise is made in an unenforceable arrangement or fails the 'sufficiently specific' criterion, the transaction will fall outside the scope of AASB 15 and the NFP entity shall consider if AASB 1058 is applicable.

To assist NFP entities in applying the requirements of AASB 15, the AASB has issued additional NFP-specific implementation guidance in AASB 15. It is important to note that while AASB 15 has 5 steps in the revenue recognition model, the AASB has only issued NFP-specific implementation guidance for three of the 5 steps as illustrated in the diagram below.



6a. Step 1: Identify 'enforceable' agreements with a 'customer'

Customer

In contracts with customers, AASB 15 states that the 'customer' is the party that promises consideration in exchange for goods/services that are an output of the entity's ordinary activities for which it obtains all, or substantially all, of the benefits from those goods/services.

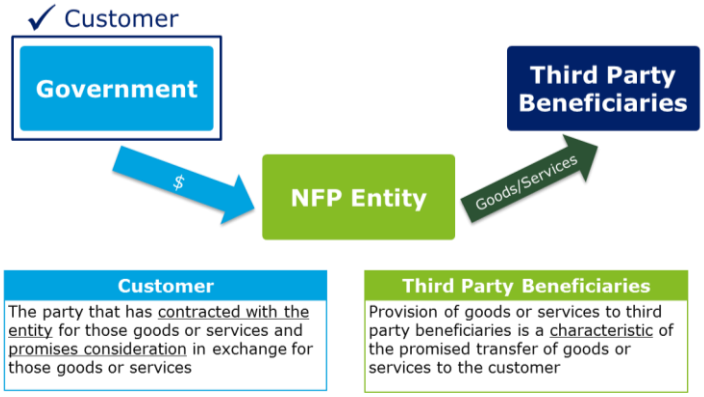
However, in contracts with customers in the NFP sector, it is very common for arrangements whereby the customer that promises consideration might direct that goods or services are to be provided to third-party beneficiaries (including individuals or the community at large) on the customer's behalf.

The NFP-specific guidance clarifies that in these contracts:

- the customer remains the party that has contracted with the entity for those goods or services and promises consideration in exchange for those goods or services; and
- the provision of goods or services to third-party beneficiaries is a characteristic of the promised transfer of goods or services to the customer.

For example, a NFP entity in the private sector may receive consideration from a government for the specified purpose of providing first-aid training free of charge to members of the community. The government is the customer because it has contracted the entity to provide the first-aid training services. This conclusion is not affected by the fact that the government specifies that those services are to be provided to members of the community.

This is illustrated in the diagram below.



'Enforceable' agreement

An inherent feature of a contract with a customer is that the entity makes promises in an agreement that creates enforceable rights and obligations. An agreement is enforceable when a separate party is able to enforce it through legal or 'equivalent means'. For an agreement to be enforceable through 'equivalent means', the presence of a mechanism outside the legal system that establishes the right of a separate party to oblige the entity to act in a particular way or be subject to consequence is required.

It is important to note that enforceability depends solely on the customer's capacity to enforce its rights. Accordingly, the assessment of enforceability does not require a history of enforcement of similar agreements by the customer or even an intention of the customer to enforce its rights.

Some common examples of terms that would result in enforceable agreements are:

- ✓ a refund in cash or kind is required when the agreed specific performance has not occurred;
- ✓ the customer, or another party acting on its behalf, has a right to enforce specific performance or claim damages; or
- ✓ the customer has the right to take a financial interest in assets purchased or constructed by the entity with resources provided under the agreement.

In contrast to the examples above, the following circumstances would not, of themselves, result in enforceable agreements:

- × a transferor has the capacity to withhold future funding to which the entity is not presently entitled; and
- × a NFP entity publishes a statement of intent to spend money or consume assets in particular ways.

Observations

NFP entities will need to analyse their funding arrangements to determine whether each arrangement is enforceable to assess if the arrangement falls within the scope of AASB 15. The enforceability of an arrangement will affect whether the arrangement is accounted for under AASB 15 or AASB 1058, which will in turn result in either immediate income recognition or potential income deferral.

This assessment will require NFP entities to analyse each of their contracts at a level of detail that was previously not required and given the level of judgement and complexity involved, we recommend that entities commence analysis in the light of these new requirements as early as possible.

6b. Step 2: Identify 'sufficiently specific' promises in performance obligations

AASB 15 requires that to enable an entity to identify the performance obligations that it should account for separately, each promise to transfer goods or services needs to be distinct – individually, or if not individually, as a bundle combined with other promises. As the specificity of the promise to transfer goods or services can be quite different in the for-profit and NFP sectors, the AASB has introduced an additional level of consideration that is specific to NFP entities when assessing performance obligations.

A necessary condition for identifying a performance obligation of a NFP 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', which takes into account any conditions specified in the arrangement 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 goods or services must be transferred.

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 above needs to be specified in an agreement for the promise to be sufficiently specific. Accordingly, this is one of the key areas of significant judgement of the new income recognition requirements for NFP entities and also has implications for the income recognition pattern.

In cases where entities receive a transfer to be used over a particular time period for specified services, such a transfer could meet the 'sufficiently specific' criterion.

An example would be a charity receives a government grant of $1 million and has an agreement with the grantor that specifies the grant must be spent providing crisis counselling services to victims of violence for a given number of hours per week for the entire year ending 30 June 20X1. In this case, the transfer would meet the 'sufficiently specific' criterion as it enables a determination of when the services have been provided.

However, if the transfer does not specify the period over which the entity must use the funds or the services to be provided, the entity would not meet the 'sufficiently specific' criterion because it would be unable to determine when it meets the performance obligations.

Observations

AASB 15 requires the specificity of performance obligations to be assessed separately for each promise and while it provides some aspects of conditions for entities to consider, it does not prescribe a specific number or combination of the conditions in order for the promise to be sufficiently specific.

NFP entities will need to:

- analyse their funding arrangements to determine whether the conditions specified in each arrangement are considered to be 'sufficiently specific' to assess if the arrangement falls within the scope of AASB 15
- The specificity of performance obligations specified in an arrangement will affect the accounting for the arrangement which will result in:
  - potential income deferral under AASB 15; or
  - immediate income recognition under AASB 1058.

This assessment will require NFP entities to analyse each of their arrangements at a level of detail that was previously not required and given the level of judgement and complexity involved, we advise entities to start assessment of these new requirements as early as possible. Furthermore, there is the need to consider the impact on new contract negotiations regarding the level of detail of the specified conditions for entities that want an arrangement to be scoped in AASB 15 to enable the opportunity for income deferral.

6c. Step 4: Allocate transaction price to 'donation' element in contract

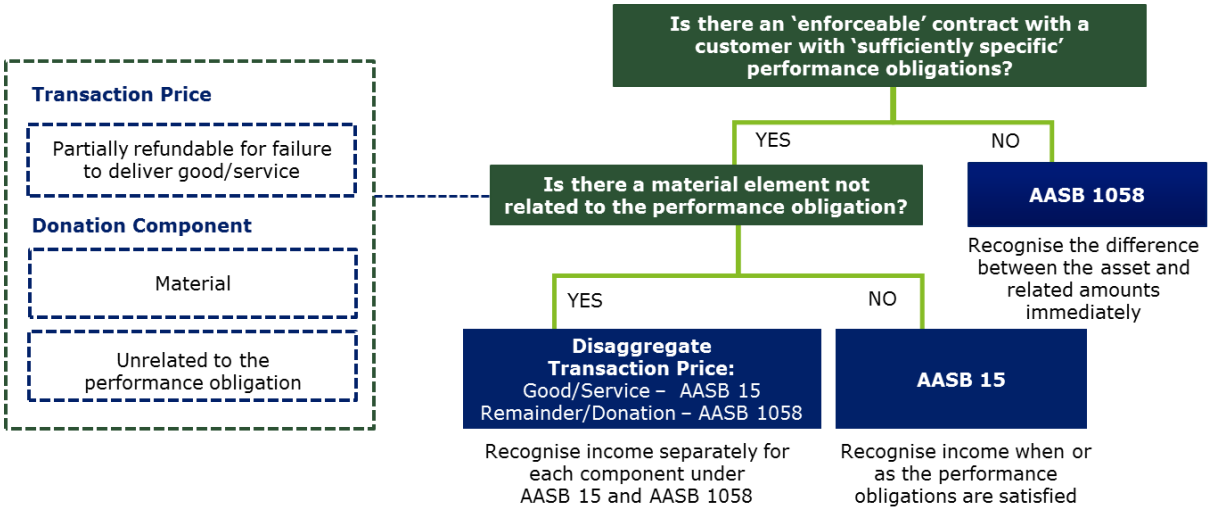
In the NFP sector, a customer may enter into a contract with a NFP entity with a dual purpose of obtaining goods or services and to provide a donation to help the not-for-profit entity achieve its objectives.

In such cases, AASB 15 requires a NFP entity to consider if the donation element should be separately accounted for. There is a rebuttable presumption that the donation element is not separately accounted for and the transaction price is treated as wholly related to the transfer of promised goods or services. The presumption is rebutted where the transaction price is partially refundable in the event the entity does not deliver the promised goods or services.

Where the presumption is rebutted, the entity shall disaggregate the transaction price and account for the component that relates to the transfer of promised goods or services in accordance with AASB 15. The remainder of the transaction price (being the material element not related to the performance obligation) shall be accounted for separately in accordance with AASB 1058.

To disaggregate the component that relates to the promised goods or services, the following may be indicative of an element that is not related to the promised goods or services (and more likely to be for the purpose of enabling the not-for-profit entity to further its objectives):

a) a non-refundable component of the transaction price; and
b) where the entity has the status of a deductible gift recipient – the donor can claim part of the transaction price as a tax deduction for a donation.



Observation
The requirement in AASB 15 to componentise contracts into a revenue element and a donation element may pose practical challenges for NFP entities. In some cases, it may not be readily apparent that a donation element is unrelated to the promised goods or services in the contract and therefore is required to be separately recognised under AASB 1058.

7. Disclosures and presentation

AASB 1058 and AASB 15 significantly expand the disclosure requirements for NFP entities, particularly for NFP entities in the private sector. This is particularly important to note as whilst entities may reach the same accounting treatment under the new income requirements, as compared to the current accounting, the increased disclosure burden will require additional assessment to be performed by entities to comply with the new requirements.

The new disclosure requirements are discussed below.

7a. AASB 1058

For income accounted for under AASB 1058, a NFP entity is required to disclose the income recognised during the period disaggregated into categories that reflect how the nature and amount of income (and the resultant cash flows) are affected by economic factors. A NFP entity should consider disclosing the following categories:

- grants, bequests and donations of cash, other financial assets and goods;
- recognised volunteer services; and
- for government departments and other public sector entities, appropriation amounts recognised as income, by class of appropriation.

For non-contractual income arising from statutory requirements (such as taxes, rates and fines), AASB 1058.28-30 includes the following disclosure requirements, some of which differ from current disclosure requirements in AASB 1004:

- income arising from statutory requirements recognised during the period disaggregated into categories that reflect how the nature and amount of income are affected by economic factors
- assets and liabilities recognised in accordance with AASB 1058, specifically:
  - receivables that are not a financial asset as defined in AASB 132 (e.g. income tax receivable from a taxpayer) and the interest income and impairment losses recognised in relation to such receivables during the period;
  - financial liabilities relating to prepaid taxes or rates for which the taxable event has yet to occur, and the future period(s) to which those taxes or rates relate.
- for each class of taxation income that the entity cannot measure reliably during the period in which the taxable event occurs (refer to AASB 1058.B28-B31):
  - information about the nature of the tax;
  - the reason(s) why that income cannot be measured reliably; and
  - when that uncertainty might be resolved.

AASB 1058 prescribes additional disclosure requirements for transfers to enable an entity to acquire or construct a non-financial asset for its own use [AASB 1058.31-36], which include:

- opening and closing balances of financial assets and the associated liabilities arising from such transfers
- information about its obligations under such transfers, including a description of when the entity typically satisfies its obligations (for example, as the asset is constructed, upon completion of construction or when the asset is acquired)
- explanation of when it expects to recognise as income any liability for unsatisfied obligations as at the end of the reporting period
- judgements, and changes in the judgements, made in applying the Standard that significantly affect the determination of the amount and timing of income, specifically on the timing of satisfaction of obligations

For government departments and public sector entities, AASB 1058 carries forward the disclosure requirements regarding parliamentary appropriations from AASB 1004 virtually unamended [AASB 1058.38-41].

While it is not a disclosure requirement, AASB 1058 encourages NFP entities to make the following disclosures:

- qualitative information, by major class of transaction, about the nature of the entity's dependence arising from:
  - volunteer services it receives, including those not recognised; and
  - inventories (donated) held but not recognised as assets during the period [AASB 1058.27]; and
- externally imposed restrictions that limit or direct the purpose for which resources controlled by the entity may be used [AASB 1058.37], specifically:
  - judgements used in determining whether funds are restricted;
  - assets to be used for specified purposes;
  - components of equity divided into restricted and unrestricted amounts (see illustration below – source: Example 13 of AASB 1058); and
  - total comprehensive income divided into restricted and unrestricted amounts – either on the face of the statement of profit or loss and other comprehensive income or in the notes (see illustration below – source Example 13 of AASB 1058).

Example: Components of equity divided into restricted and unrestricted amounts [AASB 1058.37(b)]:

Changes in Restricted Net Assets	*20X6*	*20X5*
Opening balance	$3,000,000	$900,000
Grant income received – time restricted	$2,400,000	$3,000,000
Grant funds – time restrictions expired during the year	$(1,000,000)	$(900,000)
Closing balance	**$4,400,000**	**$3,000,000**

Example: Total comprehensive income divided into restricted and unrestricted amounts [AASB 1058.37(c)]:

Summary of Statement of Profit and Loss and Other Comprehensive Income	*20X6*	*20X5*
Donation income – restricted	$800,000	$700,000
Donation income – unrestricted	$2,400,000	$3,000,000
Other revenue	$850,000	$820,000
Total revenue	**$4,050,000**	**$4,520,000**
Total expenses	$1,700,000	$1,300,000
Total comprehensive income	**$2,350,000**	**$3,220,000**
Total comprehensive income – unrestricted	($50,000)	$220,000
Total comprehensive income – restricted	$2,400,000	$3,000,000

7b. AASB 15

For NFP entities with income recognised within the scope of AASB 15, there is no NFP-specific disclosure relief from AASB 15 disclosure requirements. Accordingly, Tier 1 NFP entities will need to comply with all disclosure requirements set out in AASB 15 and Tier 2 NFP entities applying RDR will need to comply with RDR requirements of AASB 15.

For Tier 1 NFP entities with income accounted for under AASB 15, the new disclosure requirements significantly expand on current disclosure requirements. Some key disclosures to note are:

- a disaggregation of revenue to 'depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors';
- certain information about contract balances (e.g. opening and closing balances of receivables, contract assets and liabilities)
- for contracts that are expected to extend beyond a year, the aggregate transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that revenue;
- information about assets recognised for costs to obtain or fulfil a contract;
- qualitative descriptions of the types of goods or services, significant payment terms and typical timing of satisfying obligations of an entity's contracts with customers;
- a description of the significant judgements about the amount and timing of revenue recognition; and
- information about the methods, inputs and assumptions used to determine the transaction price and to allocate amounts to performance obligations.

8. Effective date and transition

8a. Transition requirements

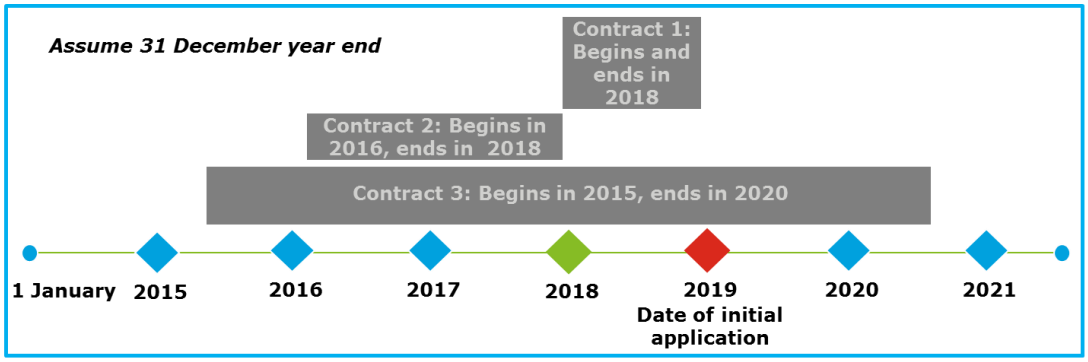
The new income recognition requirements are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted provided entities adopt both AASB 1058 and AASB 15 for the same period. The requirements apply to contracts created on or after the effective date and to existing contracts that are not yet complete as of the effective date. Therefore, the current year figures reported in the first year of adoption will be prepared as if AASB 1058 requirements had always been applied.

In respect of comparative periods, entities have the option of using either:

- retrospective application (with practical expedient for completed contracts) or
- modified approach, when applying AASB 1058.

Under the retrospective application, AASB 1058 provides a practical expedient that entities are not required to restate completed contracts that begin and end within the same annual reporting period or are completed contracts at the beginning of the earliest period presented. If an entity elects to use this practical expedient, it must disclose the use of this expedient.

Under the modified approach, comparative years are not restated. Instead, an entity recognises the cumulative effect of initially applying AASB 1058 for the first time for the year ending 31 December 2019 and chooses to apply the modified approach, the cumulative effective resulting from the application of AASB 1058 will be adjusted against retained earnings as at 1 January 2019. The comparative figures for year ending 31 December 2018 will not be restated. If an entity elects to use the modified approach, it must disclose the impact of the amount by which each financial statement line item is affected in the current period by application of AASB 1058 as compared to AASB 1004 before the change and include an explanation of the reasons for the significant changes.
The following diagram illustrates how three different contracts would be treated on transition using both methods permitted in the Standard.



	Retrospective Approach	Modified Approach
Contract 1	Begins and ends in same annual reporting period – practical expedient available	Contract completed before date of initial application – do not apply AASB 1058
Contract 2	Adjust opening retained earnings (or other component of equity) for earliest prior period presented – 1 January 2018	Contract completed before date of initial application – do not apply AASB 1058.
Contract 3	Adjust opening retained earnings (or other component of equity) for earliest prior period presented – 1 January 2018	Adjust opening retained earnings (or other component of equity) at date of initial application – 1 January 2019. Make specific required disclosures. Figures for 2018 are not restated.

8b. Interaction between AASB 1058, AASB 15 and AASB 16

Whilst AASB 1058, AASB 15 (for not-for-profit entities) and AASB 16 are applicable for periods beginning on or after 1 January 2019, it is important to note that for entities that want to early adopt certain Standards (instead of the suite of all 3 Standards) should be aware of the restrictions that apply.

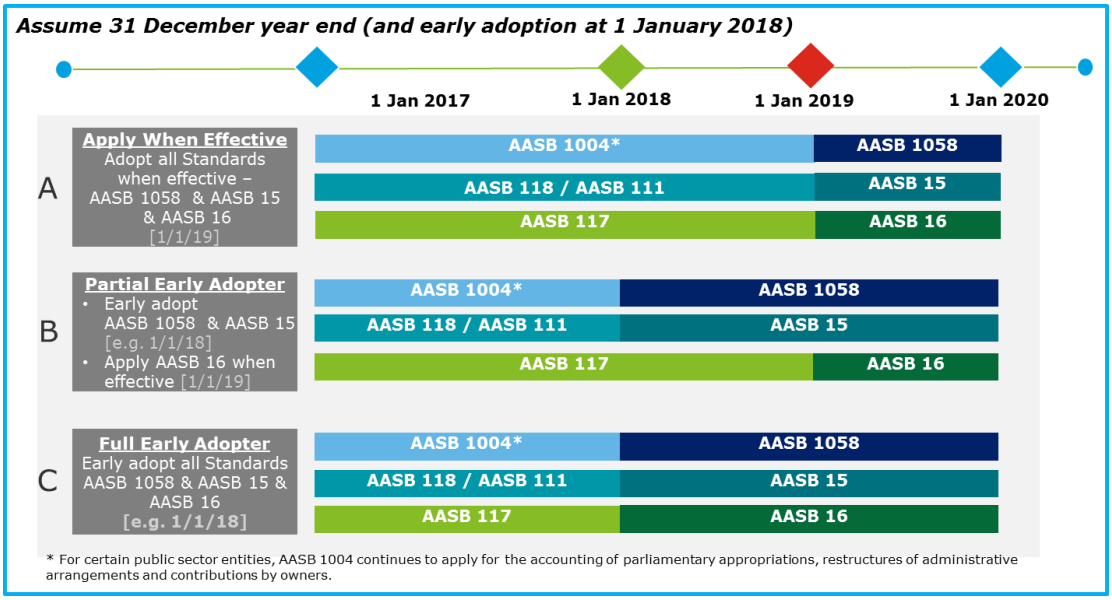
The following diagram shows the 3 possible paths for adoption of AASB 1058, AASB 15 and AASB 16:

A. Apply all Standards when Effective
Entities can choose to apply all Standards (AASB 1058, AASB 15 & AASB 16) when effective for periods beginning 1 January 2019.

B. Partial Early Adoption
Entities can choose to early adopt AASB 1058 and AASB 15 (e.g. 1 January 2018) and subsequently apply AASB 16 when effective (1 January 2019). The transitional requirements of AASB 1058 and AASB 15 requires both Standards to be early adopted together at the same time.

C. Full Early Adoption
Entities can choose to early adopt all Standards (AASB 1058, AASB 15 & AASB 16) at an earlier application date (e.g. 1 January 2018).

It is not possible for entities to early adopt AASB 16 on its own without also adopting AASB 15 and AASB 1058. The transition requirements of AASB 16 require that when an entity early adopts AASB 16, it is required to also early adopt AASB 15 which consequently means the entity will also need to early adopt AASB 1058.



8c. Specific transition requirements for leases at significantly below market terms (peppercorn leases)

For leases at significantly below market terms and conditions, AASB 1058 contains specific transition requirements for such leases that differ from the general transition requirements of AASB 1058.

As mentioned above in section 8b, entities can choose to apply both AASB 1058 and AASB 16 at the same time or early adopt AASB 1058 before the mandatory application date of AASB 16, thereby applying AASB 1058 alongside AASB 117. Depending on whether an entity chooses to early adopt AASB 1058 before AASB 16 and the chosen transition option (retrospective approach vs. modified approach), the transitional requirements will differ. This is illustrated in the diagram below.

Entities applying AASB 1058 before AASB 16 – **Scenario B per diagram above**

Operating leases

On early application of AASB 1058, the entity will continue to apply the requirements of AASB 117 until transition to AASB 16. Entities are not required to recognise any asset or income when adopting AASB 1058.

On subsequent transition to AASB 16, the entity will be required to recognise the right-of-use asset at fair value at the date of application of AASB 16. The lease liability will be measured in accordance with AASB 16 along with any 'related amounts' recognised in accordance with AASB 1058.9 with any difference being recognised as income arising as an adjustment to opening balance of retained earnings.

Finance leases

On early application of AASB 1058, the entity will recognise:

- the right-of-use asset at fair value in accordance with AASB 13
  - retrospective approach: at the beginning of the earliest period presented
  - modified approach: at date of initial application of AASB 1058
- lease liability in accordance with AASB 117
- any related amounts in accordance with AASB 1058.9
- income arising as an adjustment to opening balance of retained earnings
  - retrospective approach: at the beginning of the earliest period presented
  - modified approach: at date of initial application of AASB 1058

On subsequent transition to AASB 16, the entity is not required to remeasure the leased asset to fair value.

Entities applying AASB 1058 and AASB 16 at the same time – **Scenario A or C per diagram above**

For both operating leases and finance leases, on application, the entity will recognise:

- the right-of-use asset at fair value in accordance with AASB 13
  - retrospective approach: at the beginning of the earliest period presented
  - modified approach: at date of initial application of AASB 16
- lease liability in accordance with AASB 16
- any related amounts in accordance with AASB 1058.9
- income arising as an adjustment to opening balance of retained earnings
  - retrospective approach: at the beginning of the earliest period presented
  - modified approach: at date of initial application of AASB 16

Entities with leases at significantly below market terms principally to enable it to further its objectives

	Early Adopt AASB 1058 (e.g. 1/1/18) before AASB 16 (1/1/19)				Adopt both AASB 1058 and AASB 16 at the same time (e.g. 1/1/19)			
	Operating Lease		Finance Lease		Operating Lease		Finance Lease	
	Retrospective Method	Modified Method	Retrospective Method	Modified Method	Retrospective Method	Modified Method	Retrospective Method	Modified Method
Source Reference	AASB 1058. C9	AASB 1058. C9	AASB 1058.C10(a) AASB 117. Aus20.1	AASB 1058.C10(a) AASB 117. Aus20.1	AASB 16. AusC5.1 & Aus25.1	AASB 16. AusC8.1 & Aus25.1	AASB 16. AusC5.1 & Aus25.1	AASB 16. AusC11.1 & Aus25.1
Lease Asset	Continue to apply AASB 117	Continue to apply AASB 117	Fair value (AASB 13) at the beginning of earliest period presented * [1/1/17]	Fair value (AASB 13) at the date of initial application of AASB 1058 * [1/1/18]	Fair value (AASB 13) at the beginning of earliest period presented [1/1/18]	Fair value (AASB 13) at the date of initial application of AASB 16 [1/1/19]	Fair value (AASB 13) at the beginning of earliest period presented [1/1/18]	Fair value (AASB 13) at the date of initial application of AASB 16 [1/1/19]
	Apply AASB 16 transition requirements on transition to AASB 16 [1/1/19]							
Lease Liability	Continue to apply AASB 117	Continue to apply AASB 117	In accordance with AASB 117	In accordance with AASB 117	In accordance with AASB 16	In accordance with AASB 16.C8(a)	In accordance with AASB 16	In accordance with AASB 16
'Related Items'	N/A – do not apply AASB 1058	N/A – do not apply AASB 1058	In accordance with AASB 1058	In accordance with AASB 1058	In accordance with AASB 1058	In accordance with AASB 1058	In accordance with AASB 1058	In accordance with AASB 1058
'Income arising'	N/A – do not apply AASB 1058	N/A – do not apply AASB 1058	Adjustment to opening retained earnings at beginning of earliest period presented [1/1/17]	Adjustment to opening retained earnings at date of initial application of AASB 1058 [1/1/18]	Adjustment to opening retained earnings at beginning of earliest period presented [1/1/18]	Adjustment to opening retained earnings at date of initial application of AASB 16 [1/1/19]	Adjustment to opening retained earnings at beginning of earliest period presented [1/1/18]	Adjustment to opening retained earnings at date of initial application of AASB 16 [1/1/19]

* On transition to AASB 16 (1/1/19), entities that have early adopted AASB 1058 are not required to remeasure the fair value of the right-of-use asset of finance leases [AASB 16.AusC5.2]

Observation

As is evident in the diagram above, the transitional requirements for peppercorn leases can be complex due to the different requirements depending on the lease classification, the application dates of AASB 1058 and AASB 16 and the chosen transition options.

For all peppercorn leases, it is important to note that regardless of the lease classification, the application dates of AASB 1058 and AASB 16 or the chosen transition options, the lease asset will need to be measured at fair value in accordance with AASB 13 and any 'income arising' (being the difference between the asset's fair value, lease liability measured in accordance with AASB 117 / AASB 16 and any 'related items') will result in an adjustment to opening balance of retained earnings. The date of the asset's fair value measurement and the date of the adjustment to opening retained earnings will either be at the date at the beginning of the earliest period presented or the date of initial application of AASB 16/AASB 1058 (depending on the lease classification, the application dates of AASB 1058 and AASB 16 and the chosen transition options).

Given the requirement to determine / obtain valuations in order to measure the lease asset at the fair value of the leased property at inception of the lease, NFP entities should start considering how they intend to adopt AASB 1058 and AASB 16 (whether they plan to early adopt AASB 1058 before AASB 16 or whether they plan to adopt AASB 1058 and AASB 16 at the same time) as well as the transition method (full retrospective method vs. modified method) as this will impact the date of the fair value determination of the lease asset and the adjustment to opening retained earnings.

9. Planning for impacts

Although the effective date of the new income requirements is still some time away, the AASB has set this date recognising that some entities will need the intervening period to transition to the new requirements. In particular, some NFP entities may need to change systems and processes, and to develop two sets of revenue and balance sheet systems concurrently to meet the transition requirements.

It is also important to note that there is no NFP-specific disclosure relief from AASB 15 disclosure requirements. Given the potential change in the extent of additional disclosures that will need to be included in the financial statements for financial periods beginning on or after 1 January 2019, entities are encouraged to begin preparing for these disclosures by ensuring they have the systems in place to capture all of the required information.

In addition to the increased disclosure requirements, NFP entities should also consider the other implementation challenges from the new income recognition requirements.

- For significant funding by way of corporate funding and / or government grants and donations, NFP entities will need to conduct detailed reviews of the contracts to assess:
  - the 'enforceability' of the contracts and
  - the 'sufficiently specific' criterion of performance obligations.

  This assessment will determine whether the transaction should be accounted for:
  - under AASB 15 (with the opportunity for income deferral) or
  - under AASB 1058 (income recognition on receipt).
- For NFP entities that enter into leases at significantly below-market terms and conditions, there will now be a need to obtain the valuation for such leases, which was previously not required.

Given the significant changes that are expected for NFP entities, we recommend commencement of analysis of the impacts of these new requirements. Specifically, NFP entities will need to:

- Review the terms of the funding arrangements and assess the accounting implications under AASB 15 and/or AASB 1058 (in some cases, there may be potential for contract negotiation or re-negotiation on the terms or conditions that will impact whether the contract is accounted for under AASB 15 or AASB 1058);
- Analyse contracts and assess the impact of the amount and timing of revenue recognition and then develop processes to capture and track the required accounting for the various income streams;
- Consider the impacts to stakeholders (e.g. donors, grant bodies, regulators and financiers) arising from any changes on the amount and timing of revenue recognition;
- Develop revised accounting policies and disclosures to comply with the requirements of the new Standards; and
- Assess the impact on compliance reporting, budgeting and covenants as a result of changes in the timing of revenue recognition.

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