Not-for-profit entities: income recognition

Reporting Update

31 January 2017, 17RU-001

Highlights

- AASB issues new income recognition and measurement requirements applying to not-for-profit (NFP) entities
- AASB 1058 *Income for Not-for-Profit Entities*
- Implementation guidance for NFP entities on when AASB 15 would apply
- Effective date and transition

Income recognised on basis of enforceability and performance obligation assessments

AASB issues new income recognition and measurement requirements applying to not-for-profit (NFP) entities

The Australian Accounting Standards Board (AASB) has issued the new Australian accounting standard and implementation guidance on the recognition and measurement of income for NFP entities.

The concept of reciprocal and non-reciprocal transactions has been removed, and instead an assessment of enforceability and performance obligations is required. The new guidance will replace the income recognition requirements relating to private sector NFP entities and the majority of income recognition requirements relating to public sector NFP entities previously reflected in AASB 1004 *Contributions* for financial years beginning 1 January 2019 onwards.

"The application of this new guidance for income recognition for not-for-profit entities will be a challenge for most entities. We urge early consideration of all aspects of implementing this new guidance, from analysing terms and conditions of grant and research agreements, to communicating with stakeholders on the timing of income recognition, and to systems and process changes needed to ensure all relevant information is able to be captured and assessed".

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AASB 1058 *Income for Not-for-Profit Entities* is the new Australian accounting standard that establishes principles for NFP entities that apply specifically to transactions where the consideration to acquire an asset is significantly less than fair value principally to enable a NFP entity to further its objectives; and to volunteer services received.

Where such a transaction meets the requirements of AASB 15 *Revenue from Contracts with Customers*, revenue will be recognised in accordance with the requirements of this standard. To assist NFPs apply AASB 15 to their circumstances, specific implementation guidance and illustrative examples have been inserted into AASB 15.

Australian specific amendments and implementation guidance has also been added to AASB 9 *Financial Instruments* for NFP entities to apply the initial recognition and measurement requirements of AASB 9 to non-contractual receivables arising from statutory requirements as if those receivables are financial instruments. Such non-contractual receivables would include taxes, rates and fines.

AASB 1058 is the principal standard guiding recognition and measurement of income for not-for-profit entities

AASB 1058 Income for Not-for-Profit entities

Where a transaction does not meet the requirements to be accounted for under AASB 15 as it is either not an enforceable contract or the performance obligations are not sufficiently specific (refer below), a NFP entity needs to assess whether the transaction should be accounted for under AASB 1058.

Examples would include 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 acquired for nominal or low amounts.

AASB 1058 contains application guidance in Appendix B. Numerous illustrative examples are also provided to illustrate aspects of AASB 1058, although care must be taken to consider the specific facts and circumstances of the transaction being analysed, rather than relying on the illustrative examples for interpretive guidance.

When does AASB 1058 apply?

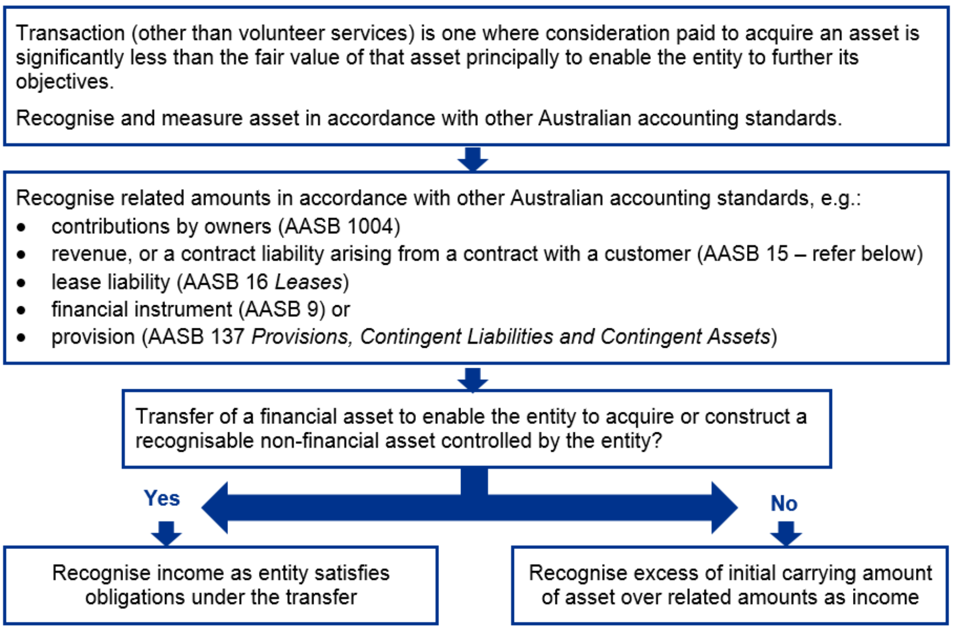
A NFP entity applies AASB 1058 to:

- transactions where the consideration paid to acquire an asset is significantly less than fair value of that asset principally to enable the entity to further its objectives; and
- receipt of volunteer services.

Consideration paid to acquire an asset is significantly less than fair value of that asset principally to enable the entity to further its objectives.

To determine whether the transactions meets the criteria of the consideration paid to acquire an asset being significantly less than fair value of that asset principally to enable the entity to further its objectives, the entity may consider whether another entity could have obtained the asset under the same terms and conditions. If not, it is more likely that the transaction is principally to enable the entity to further its objectives.

How and when to account for income for not-for-profit entities



A transfer of a financial asset to enable the entity to acquire or construct a recognisable non-financial asset controlled by the entity is one that:

- requires the entity to use that financial asset to acquire or construct a recognisable 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.

If an asset cannot be recognised under Australian accounting standards, for example cash received is for research which is unable to be recognised as an asset in accordance with AASB 138 *Intangible Assets*, then relevant consideration would be recognised as income immediately.

The application guidance in Appendix B discusses the recognition of refund obligations and circumstances in which a liability might be recognised. A liability would only typically be recognised where a breach of the arrangement had occurred or is expected to occur and there is a requirement to return the funds due to the breach.

Volunteer services

An accounting policy choice is provided in relation to volunteer services.

- Where volunteer services can be reliably measured, an entity can elect to recognise the fair value of these services as an asset or expense.
- Local governments, government departments, general government sectors (GGS) and whole of government are required to recognise volunteer services if they would have been purchased had they not been donated and the fair value can be reliably measured.

Disclosures relating to volunteer services, whether recognised or not, are also required to assist users to understand the contribution that volunteer services provide and any dependence the entity may have on these services in achieving its objectives.

What requirements are still in AASB 1004?

AASB 1004 has been retained, however, the majority of the requirements contained in the standard have been deleted, with AASB 1058 being the relevant Australian accounting standard for such contributions. The remaining requirements in AASB 1004 relate to:

- parliamentary appropriations to government departments;
- restructure of administrative arrangements for other government controlled NFP entities; and
- contributions by owners and distributions to owners by local governments and whole of government.

In particular, the requirements specified in the current AASB 1004 relating to contributions by owners and distributions by owners have been retained. The AASB intends to consider these issues as a separate project in the future.

Disclosures

The standard requires extensive disclosures relating to transactions where the consideration paid to acquire an asset is significantly less than fair value of that asset principally to enable the entity to further its objectives, and for volunteer services received.

There are also specific disclosure requirements for income arising from statutory requirements, such as taxes, rates and fines.

Information regarding externally imposed restrictions that limit or direct the purpose for which resources controlled by the entity may be used is encouraged to be disclosed. Illustrative examples are provided of such disclosures.

Specific disclosures relating to compliance with parliamentary appropriations and other related authorities for expenditure of government departments and other public sector entities previously contained in AASB 1004 is also included in AASB 1058.

Australian specific paragraphs, implementation guidance and illustrative examples added to AASB 15 *Revenue from Contracts with Customers* for not-for-profit entities

Implementation guidance for NFP entities on when AASB 15 would apply

AASB 15 follows a five-step model to determine the timing and amount of revenue to recognise. AASB 15 is generally written from a for-profit perspective, however, revenue of a NFP entity will be recognised in accordance with the requirements of this standard where an arrangement:

- is with a customer;
- is an enforceable agreement;
- has identifiable performance obligation(s); and
- is sufficiently specific to identify when the performance obligation(s) are satisfied.

Australian specific guidance has been added to AASB 15. The guidance is in the form of:

- Australian specific ('Aus') paragraphs – which cover the following issues specific to NFP entities and clarifies:
  - a transfer of a financial asset to enable an entity to acquire or construct a recognisable non-financial asset that is to be controlled by the entity is not within the scope of AASB 15. Guidance on such transactions is included in AASB 1058
  - a contract may be partially within the scope of AASB 15 and partially within scope of AASB 1058
  - if the contract is unenforceable and/or not sufficiently specific, it is not a contract witin the scope of AASB 15 and the income recognition requirements of AASB 1058 must be considered for such contracts.
- Appendix F – Australian implementation guidance for NFP entities
- Australian illustrative examples for NFP entities – which illustrate aspects of the Australian specific guidance in Appendix F.

Five steps of the AASB 15 revenue recognition model

Appendix F mainly deals with implementation guidance in relation to steps one, two and four of the AASB 15 revenue recognition model.

1 Identify the contract with the customer

The **customer** is the party that promises consideration in exchange for goods or services, however, it is acknowledged that the customer may direct a good or service be provided to third party beneficiaries on the customer's behalf. This is often the case for NFP entities.
A **contract** may be written, oral or implied by customary business practices. In order to be an enforceable agreement, there must be sufficiently specific requirements of the parties. A formal contract is not required – and could take the form of Administrative Arrangements or statutory provisions. Such arrangements are common in the NFP sector, however, each transaction needs to be assessed on its specific facts and circumstances.
Enforceability is dependent on the customer's capacity to enforce (through legal or equivalent means) its rights. An agreement does not meet the enforceable criteria through merely a statement of intent or the withholding of future funds to which the NFP entity is not yet entitled.

2 Identify the separate performance obligations in the contract

Identifying any performance obligations is a matter of judgement.
There must be a promise to transfer a good or a service to a customer for a performance obligation to be identified. 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. A stipulation of time alone is not of itself sufficiently specific to establish the existence of a performance obligation.
An acquittal process may assist in determining whether a promise to transfer a good or service is sufficiently specific such that a performance obligations exists and when they are met or satisfied.

3 Determine the transaction price

4 Allocate the transaction price to the separate performance obligations

The transaction price received may be for a dual purpose – for both the transfer of a good or service and to help an NFP entity in further achieving its objectives (i.e. a donation).
In such a situation, there is a rebuttable presumption the transaction price is wholly related to the transfer of a promised good or service i.e. all within the scope of AASB 15.
The presumption is rebutted where there is a partial refund in the event the entity does not deliver a good or service.

5 Recognise the revenue when (or as) the entity satisfies a performance obligation

More information on AASB 15 is available on our IFRS – Revenue webpage, including a consideration of issues in-depth and transition options.

Effective date and transition

Effective date

The requirements of AASB 15 for NFP entities and AASB 1058 and the related amendments, are applicable for financial years beginning on or after 1 January 2019. Early adoption is permitted as long as AASB 15 is applied to the same period.

For entities with a 30 June financial year end, the first year of mandatory application will therefore be the financial year ending 30 June 2020.

For for-profit entities, the application date of AASB 15 is for financial years beginning on or after 1 January 2018.

Various transition options and practical expedients to lessen the burden of adoption

Transition

There are three main ways to transition to AASB 1058.

Approach	Comparative period	First year of adoption	Date of equity adjustment 31 December y/e	30 June y/e
Retrospective – no practical expedients	AASB 1058*	AASB 1058	1 January 2018	1 July 2018
Partial retrospective – with practical expedients	Mixed requirements	AASB 1058	1 January 2018	1 July 2018
Cumulative effect	AASB 1004	AASB 1058	1 January 2019	1 July 2019

* An entity can elect not to measure certain assets at fair value where the full retrospective method is applied – see practical expedients below.

Under the partial retrospective method the new standard is applied retrospectively but an entity may elect to use one or more of the practical expedients set out below.

Where the cumulative effect approach is taken an entity also needs to disclose revenue amounts that would have been presented under AASB 1004.

Practical expedients available

To reduce the initial adoption burden, a number of practical expedients are available. These include:

- For *completed contracts*, no restatement is required of contracts that begin and complete in same annual reporting period.
- For *completed contracts* at the beginning of earliest period presented, there is an exemption from applying AASB 1058 retrospectively.
- No matter which transition option is elected, an asset, other than lease assets (refer below), acquired for consideration that was significantly less than fair value principally to enable the entity to further its objectives that was previously measured at significantly less than fair value is not required to be remeasured at fair value.

A *completed contract* is a contract or transaction for which the entity has recognised all of the income in accordance with AASB 1004.

Leases with significantly below-market terms and conditions

A NFP entity may have a lease arrangement which at inception had significantly below-market terms and conditions principally to further its objectives, e.g. a charity may have entered into a lease with a local council to lease land to build a centre to provide services to the community (i.e. to further its objectives) for an amount of $100 per annum for 35 years.

Operating leases

If AASB 1058 is applied before the new standard on leases: AASB 16, a NFP entity continues to apply its accounting policy under the existing AASB 117 *Leases* for such a lease classified as an operating lease. On transition to AASB 16 the transition requirements of that standard are applied, which would require the right-of-use asset relating to such an operating lease to be measured at fair value at the date of initial application of AASB 16.

On initial application of AASB 16, the lease liability is measured in accordance with AASB 16, any related amounts recognised in accordance with other Australian accounting standards (as required by AASB 1058 paragraph 9), and any income arising as an adjustment to the opening balance of retained earnings (or other component of equity as appropriate).

Finance leases

If AASB 1058 is applied before the new standard on leases: AASB 16, where such a lease is classified as a finance lease under AASB 117, on transition the leased asset must be measured at fair value at the beginning of the earliest period presented or the earlier of the date of initial application of AASB 1058, depending on the chosen transition option.

The lease liability is measured in accordance with AASB 117, any related amounts recognised in accordance with other Australian accounting standards, and any income arising as an adjustment to the opening balance of retained earnings (or other component of equity as appropriate).

On the subsequent initial application of AASB 16 an entity is not required to remeasure the leased asset to fair value again on adoption of AASB 16.