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Reporting Update

26 May 2015, 15RU-005

Proposals for income recognition for Not-For-Profit Entities

Existing Not-For-Profit (NFP) income guidance under AASB 1004 *Contributions* does not comprehensively address the recognition and measurement issues associated with NFP income transactions resulting in divergence in practice.

Exposure Draft *Income of Not-for-Profit Entities* (ED 260) was issued to address the divergent practice and will apply to both private and public sector NFP entities.

ED 260 has removed the concept of reciprocal or non-reciprocal income transactions, instead NFP entities will account for income arrangements either under AASB 15 *Revenue from Contracts with Customers* (AASB 15) or a new standard AASB 10XX *Income of Not-for-Profit Entities* (AASB 10XX). Which standard applies is dependent on the individual agreement's terms and conditions. Where the agreement is "enforceable" and contains "performance obligations", AASB 15 will apply. Where the agreement does not contain either one or both of these, then the new AASB 10XX will be applied.

See Appendix 1 for details on the concepts of "enforceable" and "performance obligations".

ED 260 will not apply to for-profit entities, these entities will continue to apply AASB 120 *Accounting for Government Grants and Disclosure for Government Assistance* where appropriate.

KEY POINTS

- **ED 260 proposes income recognition requirements for NFP's**
- **Income accounted for under either AASB 15 or a new NFP specific standard**
- **Accounting guidance applied depends on whether agreement is enforceable and contains performance obligations**
- **Income recognition may be accelerated or deferred compared to current treatment**
- **Submissions for comment letters due 14 August 2015**

ACTION POINTS

- **Assess which accounting guidance will be applicable to your transactions**
- **Assess potential impact on NFP's income recognition policy**
- **Consider submitting a comment letter**

AASB 15 Revenue from contracts with customers

AASB 15 *Revenue from contracts with customers* (AASB 15) provides a revised revenue recognition framework (and will replace the existing AASB 118 *Revenue* and AASB 111 *Construction Contracts* when effective). It will apply to income transactions, including NFP entities, however it is generally written from a for-profit perspective.

As NFP entities could be applying AASB 15, there is a need to understand the impacts and requirements of AASB 15 on revenue recognition.

AASB 15 follows a five-step model to determine the timing and amount of revenue to recognise. Revenue may be recognised over time, in a manner that best reflects the entity's performance, or at a point in time, when control of the good or service is transferred to the customer.

When consideration from a customer is received in advance of satisfying the performance obligation, the amount of that consideration is recognised as a contract liability.

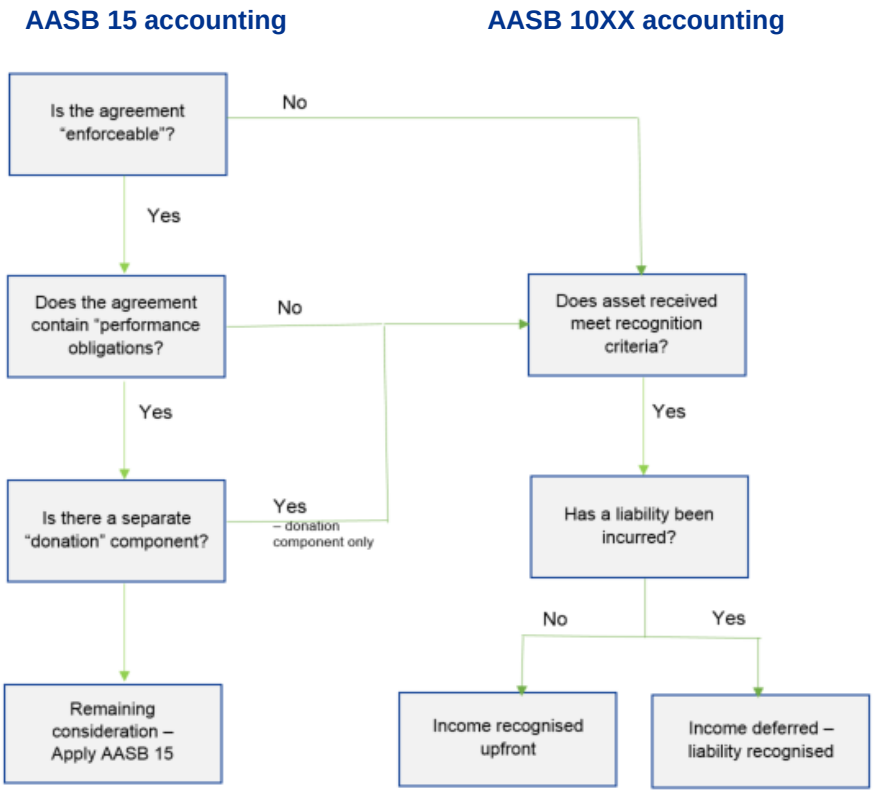
AASB 15 is effective for annual periods beginning on or after 1 January 2017[1].

For more information on AASB 15 please refer to our First Impressions: Revenue from contracts with customer's publication.

Not-for-profit income recognition under ED 260

ED 260 requires NFP entities to consider two accounting requirements when determining income recognition.

The decision tree below outlines those key areas for consideration under ED 260.



[1] The IASB has issued an exposure draft proposing to defer the effective date of this standard to 1 January 2018.

See Appendix 1 for the details of these NFP income considerations under ED 260.

KPMG Comment

It will be important to understand from the NFP sector, whether a commercial income recognition model (under AASB 15) is an appropriate income model for the NFP sector.

NFP specific issues – taxes and other transfers

There are a number of issues that are specific to NFP entities including accounting for taxes, fines, bequests and volunteer services. AASB 10XX is broadly consistent with the existing income recognition for these type of transactions. However some additional guidance and direction has been provided:

- Volunteer services – certain government and non-government NFP entities can elect to recognise volunteer services income and expense where the fair value of donated services can be measured reliably
- Assets acquired at no or nominal cost – accounting standards updated to require all non-financial assets (including finance leased assets) to be initially recognised at fair value

ED 260 is also proposing to remove the contribution by owners guidance currently included in AASB 1004. AASB is seeking comments on whether this guidance is still required.

Impacts on current practice

Understanding the change from existing NFP income interpretation

The impact on the changes proposed by ED 260 on income recognition for NFP entities will be dependent on how the NFP entity has interpreted existing income recognition criteria under AASB 1004 *Contributions* (AASB 1004).

An existing interpretation of AASB 1004 is that where there are return obligations attached to a transaction, the transaction would be considered a reciprocal transaction accounted for under AASB 118, with income deferred and recognised when the conditions are satisfied (e.g. through a stage of completion method).

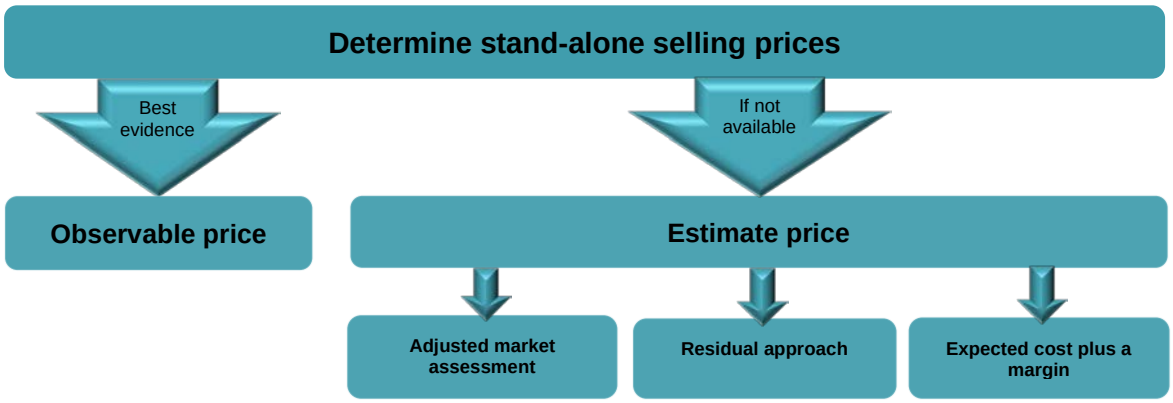
An alternative interpretation of AASB 1004 is that regardless of a return obligation attached to the transaction, where the goods or services are not for the benefit of the counterparty (i.e. benefits the community at large) this is considered a non-reciprocal transaction. Under this interpretation income is accounted under AASB 1004, with income recognised when the asset is recognised i.e. upfront income recognition.

The shift in focus from reciprocal/non-reciprocal to an assessment of enforceability and performance obligations may lead to a change in NFP entities income recognition pattern. While some income recognition may remain in line with existing practices, there is potential for an acceleration or deferral of income recognition depending on the impacts of transitioning from the existing to the new guidance.

The illustrative examples in Appendix 2 highlight the impact on income recognition depending on the NFP's existing interpretation of AASB 1004.

Allocation of transaction price under AASB 15

AASB 15 requires NFP entities to allocate the transaction price of the agreement to each individual performance obligation. This allocation is based on the following:



Even if no observable price is available the NFP entity will still be required to estimate the amount. The NFP entity is required to maximise the use of observable inputs, but in all circumstances will need to arrive at a stand-alone selling price and allocate the transaction price to each performance obligation in the agreement.

KPMG Comment

There may be significant difficulties for NFP's to obtain the relevant information to make the stand-alone value assessment. Due to the nature of the industries that NFP operates in there may be limited/no market information (e.g. what would a reasonable margin be for a NFP entity?).

Increased importance on individual agreements terms and conditions

Under the proposed changes, NFP entities will need to perform an assessment on each individual income agreement to determine which accounting standard applies.

For those entities with non-homogenous agreements, the review and assessment of the terms of each individual agreement could be a laborious and costly exercise. Also the assessment of the agreements could be subjective and require significant judgement.

Communicating with stakeholders

Stakeholders will want to understand the impact of the new standards on the overall business – probably before it becomes effective. Areas of interest may include the effect on timing of income recognition, proposed changes to business practices and costs of implementation. Income recognition for NFP's could have impacts on existing or future funding therefore it is important that there is early and frequent communication with key stakeholders such that any changes to income recognition are clearly understood.

Capturing and assessing new information

AASB 15 requires new (and more) estimates and judgements, which may require NFP entities to develop new processes to capture the relevant information at its source and to document it appropriately. Entities will also need to consider the internal controls required to ensure the completeness and accuracy of this information – in particular where it was not previously collected.

Transition requirements

An entity may choose to adopt the new standard either retrospectively or through a cumulative effect adjustment as of the start of the first period which it applies to new standard.

Application date and comment period

It is currently proposed that both these standards would be applicable to annual reporting periods beginning on or after 1 January 2017. However this application date may be delayed to 1 January 2018 depending on the outcome of the proposal to defer the effective date of IFRS 15.

The AASB has requested comments on ED 260 by 14 August 2015.

Appendix 1: Details of ED 260 accounting

The ED 260 proposals will require NFP entities to consider two accounting requirements when determining the timing and amount of income to be recognised. The income accounting standard to be applied by the NFP entity will depend on the individual agreement's terms and conditions.

- AASB 15 – applied where the agreement meets the scope of AASB 15, specifically where the arrangement is enforceable and contains performance obligations; or
- AASB 10XX – applied where the agreement is outside the scope of AASB 15 i.e. the agreement does not contain either one or both of enforceable or performance obligation elements

AASB 15 accounting – NFP guidance

In addition to AASB 15 accounting requirements, ED 260 proposes Appendix E to AASB 15. This will provide Implementation Guidance specific for NFP entities, including guidance on the assessment of the scope criteria.

To apply AASB 15 the terms of the agreement must:

- Be enforceable; and
- Contain performance obligations – i.e. sufficiently specific promises

Donations (as discussed below) are separated and are excluded from AASB 15 accounting.

1. Enforceable

An essential feature to recognise revenue under AASB 15 is that the agreement creates enforceable rights and obligations. There does not need to be a history of enforcement to meet this criteria.

Examples of an enforceable arrangement include a:

- Right or legal authority to enforce a specific performance or provide compensation – e.g. contract or Ministerial directive
- Return of compensation obligation or severe penalties for non-performance.

An agreement does not meet the enforceable criteria through a statement of intent by the NFP or the withholding of future funds to which the NFP entity is not yet entitled.

2. Performance obligations

Performance obligations are distinct promises to deliver a good or service to the customer. Performance obligations exists where the following are stipulated in the agreement:

1. Nature or type of the goods or services;
2. Cost or value of the goods or services;
3. Quantity of the goods or services;
4. Period of time of the goods or services must be transferred.

However, a stipulation of time alone is not enough to be considered a performance obligation.

Donation components

The concept of a 'donation' represents the amount of the consideration that is not attributable to the performance obligations in the agreement. Where a donation component can be separated, the consideration attributable to the donation portion is accounted for separately under AASB 10XX.

To seperately account for a donation component requires evidence of:

1. Customer intention:

Examples include:
- Promised as part of a fundraiser
- Tax deduction identified
- Additional consideration made specifically for donation purposes

And

2. Donation is separately identifiable

Evidence of separation involves:
- Not part of the consideration for performance obligations;
- Not conditional on transferring good or service; and
- Can be measured reliably

A substantial difference between the consideration and stand-alone values of the performance obligations, while cause for investigation, is not (on its own) evidence of a donation.

AASB 10XX - Income of Not-for-Profit Entities

Where an arrangement is not within the scope of AASB 15 a NFP entity will recognise income under AASB 10XX.

Income is recognised upfront at the fair value of the asset contributed to the entity less any liability incurred by the NFP entity as part of the transaction.

Under AASB 10XX income is recognised when the asset contributed is:

1. Controlled by the NFP entity;
2. Probable to flow to the NFP entity; and
3. Fair value can be measured reliably

To the extent these transactions are outside the scope of AASB 15, AASB 10XX transactions could include:

- Voluntary transfers – grants, appropriations, bequests, donations, volunteer services
- Compulsory transfers – rates, taxes and fines

The income recognition criteria under AASB 10XX is broadly consistent with the existing AASB 1004 income requirement.

Appendix 2 – Illustrative examples

Example 1a – Illustrative example of impact on timing of income recognition

The impact of ED 260 in the below examples demonstrates the potential differences in accounting outcomes based on the different interpretations of reciprocal/non-reciprocal transactions under AASB 1004.

Background facts:

- Entity A provides $100m to NFP entity to fund health initiatives
- Initiatives are clearly specified i.e. detailed requirements for the funds
- Funds are repayable if not expended as intended

Accounting assessment:		
AASB 1004 outcome[1]	**AASB 118 outcome [2]**	**ED 260 outcome**
Non-reciprocal transfer as Entity A is not beneficiary	Reciprocal transfer as return obligation attached Income recognised when meets AASB 118 recognition criteria	Contract is enforceable – due to the refund obligation Performance obligations included – as sufficiently specific detail Apply AASB 15
Income upfront Income recognised when NFP controls funds Liability is recognised when NFP fails to meet conditions and is probable the funds will be returned	**Income deferred** Income recognised based on stage of completion criteria under AASB 118	**Income deferred** Income recognised only as performance obligations are satisfied

1. AASB 1004 applied where considered non-reciprocal due to benefit not provided to counterparty
2. AASB 118 applied where considered reciprocal as arrangement contains a return obligation

Example 1b – Illustrative example of impact on timing of income recognition

Background facts:

- Facts as above
- Exception – initiative details are not considered sufficiently specific

Accounting assessment:		
AASB 1004 outcome	**AASB 118 outcome**	**ED 260 outcome**
Non-reciprocal transfer as Entity A is not beneficiary	Reciprocal transfer as return obligation attached Income recognised when meets AASB 118 recognition criteria	Contract is enforceable – due to the refund obligation No Performance Obligations – as not sufficiently specific Apply AASB 10XX
Income upfront Income recognised when NFP controls funds Liability is recognised when NFP fails to meet conditions and is probable the funds will be returned	**Income deferred** Income recognised based on stage of completion criteria under AASB 118	**Income upfront** Income recognised when NFP controls funds and no liability incurred

Example 2 – Assessment of donation component

Background facts:

- NFP holds an annual fundraising dinner
- Tickets are $1,000 per head and fully refundable if dinner is cancelled
- Ticket price is expected to reflect: (1) dinner and drinks (stand-alone value $300); (2) opportu to socialise and (3) implicit donation to the NFP

Accounting assessment:
Donation component is not separable as the ticket funds are conditional on the NFP transferring the promised goods and service (i.e. dinner and drinks etc.) to the ticket holder. As such the entire transaction is accounted for under AASB 15. NFP entity would recognise a contract liability on receipt of funds and income recognised when performance obligations satisfied (i.e. when fundraiser is held).