NOT-FOR-PROFITS: WHAT YOU NEED TO KNOW ABOUT THE NEW ACCOUNTING STANDARDS ON REVENUE/INCOME RECOGNITION

LIVE CHAT: QUESTIONS AND ANSWERS

INTRODUCTION

The new accounting standards AASB 15 Revenue from Contracts with Customers and AASB 1058 Income of Not-for-profit Entities become effective for accounting periods commencing on or after 1 January 2019.

These accounting standards are set to bring about some significant changes to the revenue and income recognition practices of not-for-profit (NFP) entities.

AASB 15 changes revenue recognition from the current "transfer of risks and rewards" model to a "transfer of control" model.

AASB 1058 is expected to more closely reflect the economic reality of the underlying transaction and will replace the vast majority of AASB 1004 *Contributions*. To some extent, AASB 1058 was developed by the Australian Accounting Standards Board to address some of the inadequacies of AASB 1004 in addressing some of the income characteristics unique to the NFP sector.

This upcoming live online chat provides you with an opportunity to ask questions of our experts about the new accounting standards on revenue and income recognition.

The experts who addressed members' questions were:

- Jeff Tulk – Partner, Saward Dawson
- Peter Shields – Partner, Saward Dawson
- Ram Subramanian – Policy Adviser – Reporting, CPA Australia.

PRIMARY RESOURCES

- AASB 15 Revenue from Contracts with Customers
- AASB 1058 Income of Not-for-profit Entities

This live chat session is provided as general guidance only for participants to obtain a better understanding of the key requirements within the accounting standards. Responses provided are of a general nature only and participants must always ensure they read and understand the requirements within the relevant accounting standards and accompanying material when applying it to their own specific circumstances.

QUESTIONS AND ANSWERS

I was looking at example 3C in AASB 1058. My school has boarders and we have some bequests like in the example. Is this transaction within the scope of AASB 1058; recognising the asset and then recognising a AASB 15 related amount? OR is the transaction within the scope of AASB 15? I thought it was the latter but given the example is in AASB 1058 maybe I am wrong. I had thought that for a transaction of this type I could ignore AASB 1058. Your thoughts?

There are examples contained in both the IE's (illustrative examples) that will be an appendix to AASB15 as well as IE's in relation to AASB1058. I would recommend organisations read through both.

The IE's in AASB1058 include examples that guide you through a process of understanding which standard applies as well as the resulting accounting treatment.

The example you refer to is for endowments used to fund student accommodation. The difference between example 3B and 3C is that 3C facts would meet the definitions of sufficiently specific performance obligations. This results in the transaction being treated in accordance with the requirements of AASB15 and therefore income is recognised as those performance obligations are met.

As a school we charge an enrolment fee for when the child starts in the following year - I believe that we will have to recognise the income over the expected life of the Childs education at our school - is this correct?

Yes, you are correct. The principle of AASB15 is that income is recognised as goods or services (performance obligations) are transferred to the customer. As the customer doesn't receive any services for that initial fee, the income is recognised over the period of the service transferred. i.e. the tuition.

This will impact schools, golf clubs and other organisations with large up-front fees.

Obviously if a student leaves earlier than we think after paying an enrolment fee then we could take up the balance to revenue once they have left. This seems to be a lot of work when you have over 1000 students. Will there be ANY exceptions to the accounting standard?

Yes, that seems appropriate. There are provisions within AASB 15 to average out the revenue across similar contracts.

If the school enrolment form states that the fee is for the funding of capital improvements would revenue treatment be different? The intended improvements would be buildings or large equipment.

AASB 1058 para 15 sets out three criteria for the construction of non-financial assets, and all three criteria must be satisfied. In the case of the school receiving a fee that includes funding for capital improvements, you would need to consider whether all three criteria are being satisfied, including whether there is an "enforceable agreement" between the school and the parent about the capital improvements.

In a church, we utilise a lot of volunteer labour such as gardening. Is it possible that a value will need to be assigned to this work and recognised as revenue?

it is optional under AASB 1058 whether you choose to value the gardening services and recognise this as revenue assuming you can reliably measure the fair value of the service.

What are some examples of arrangements that you have come across that will change under the new standards?

All NFP's preparing financial reports will be impacted. However, for some types of income the treatment will remain unchanged. For example, annual membership fees and general donations (with specific conditions attached) will likely remain unchanged.

Any organisations with grants from government or philanthropic sources where the agreements contain conditions, requirements or restrictions on use will need to consider each of these separately, particularly if the funding or activity straddles a year end.

Organisations with up-front joining or application fees e.g. private schools, golf clubs etc. will be impacted.

Organisations with peppercorn leases will need to consider the fair value requirements.

In addition, the recognition of volunteer labour is now specifically able to recognised at fair value so organisations with volunteers should consider this option.

My school is located on the land of a church. The school (and the church) have operated from here for more than 100 years. The school does not pay rent for the use of the land. Is this a peppercorn lease? A fellow school board member believes itis not a lease and therefore AASB 1058 does not apply. What do you think?

We are seeing a number of examples and issues in relation to peppercorn leases within religious entities. For your scenario:

- See example 14 in AASB 1058 for guidance
- It is clear that there is a provision of an asset below market value, being the use of the land - which is in the nature of a peppercorn lease even if it is not documented
- If there is no lease arrangement, then in accordance with AASB 1058 revenue would be recognised for the period being reported on at market value. No "right to use" asset is likely to be recognised
- However, the tenure is not specified if there is no agreement and therefore is difficult to establish the rights of the school the purposes of the new lease standard
- As such if the school does not have rights under a lease and it wants to capitalise its buildings and amortise them over the useful life, then a right of tenure is usually established through the lease agreement (often a reasonably informal agreement)
- Other considerations will include:
    - Does the school prepare general purpose or special purpose financial reports?
    - Does it intend to apply AASB 1058?
    - Does it intend to apply AASB 16?

Can you confirm that prepaid council rates can now be recognised as a prepayment rather than revenue on receipt?

I assume this is a question from the perspective of the council.

Refer to the specific example 4 of AASB 1058 as to whether the amounts are refundable. Should the rates be refundable on request the example clarifies that a liability exists under AASB 9.

If it is not refundable you would work through the income recognition requirement around performance obligations to determine timing of recognition.

We are a long service leave scheme legislated to levy employers as a percentage of remuneration in order to later pay a long service liability to workers (subject to entitlement). The levies are calculated on a two month period (i.e. May & June) but paid in July. Is the portion received in July still able to be accrued to June or does this have to be recognised only when received?

it will depend on your entitlement to the income and if the entitlement arises before June, then you would be right to accrue it in that period.

I just want to understand what is fundamental difference between old standards and new standards for revenue recognition. I always thought, you only recognize the revenue when the service/product is delivered. How this is different under the new standards?

AASB 1004 is principally based on a control concept being once you control the funds income is recognised for a contribution to a NFP.

This principle remains similar in AASB 1058 but this is only where AASB 15 does not apply. AASB 15 requires income to be recognised as the benefit is transferred to the customer.

I receive a grant to fund our operations. Specifically, to contribute to our wages bill and operating a car to transport clients. That is how we acquit our funds. This seems specific enough to me. Do you agree?

There are some good examples in AASB 1058 describing where performance obligations are sufficiently specific. Refer example 6-8.

From a practical perspective if an acquittal is able to be performed it is likely that the terms are sufficiently specific. You could look to tighten up the wording to make sure it meets the requirements and also to ensure enforceability exists also as required within AASB 15.

Do you think that those NFPs that will have to follow the new standards will have the skills to be able to comply with the new standards without having to employ advisers?

Given these are new standards with new requirements that may require a degree of judgement and interpretation, it may be appropriate to get advice from qualified/experienced professionals.

There may be simple and straightforward scenarios where the requirements are easy to apply. Also there is ample guidance and resources developed and provided by the AASB both as part of the standards and separately.

Other stakeholders are also continuing to provide guidance to assist the sector, this live web chat session is one example

I am a grantor and on 15 June each year pay annual grants for the following financial year (my financial year end is 30 June). The grant is required to be spent in a manner that is consistent with the grantee's constitution. The grant is refundable if the money is not spent in the following financial year. There are no other conditions. Some of the past grant recipients have asked me to include more specification in the grant as, if successful in receiving a grant they would like to defer recognising revenue to the year that they spend the money. Will making the arrangements more specific change my accounting as the grantor? What accounting standard deals with this?

From a grantor perspective I don't believe the inclusion of additional terms that would allow the recipient to defer based on the sufficiently specific criteria would impact your accounting treatment.

As the grantor you would need to consider if you have an asset. If the grant is for the benefit of a third party I doubt that you would meet the definition of an asset as contained in the accounting framework or any of the specific standards in relation to asset recognition and measurement (e.g. financial instruments, PP&E etc.).

You may have a potential disclosure of a contingent asset under AASB 137 if refund is probable.

My school receives capital grants at times for the purpose of the construction of new school buildings. How should this be accounted for under the new standards?

AASB 1058 para 31 requires the deferral of the income received as capital grants and recognised when you satisfy your performance obligations, which would generally be when you construct the assets the grants were provided for. Suggest looking at examples 9 and 10 as well.

When do the new standards apply?

For for-profit entities, the new standard – AASB 15 applies for periods beginning on or after 1 January 2018. Application has been deferred for NFP’s to periods beginning on or after 1 January 2019 for the adoption of AASB 15 and AASB 1058. Some organisations may want to early adopt. This is allowed with specific transitional rules applying. We would recommend you consider adopting AASB 16 Leases at the same time.

Our revenue is received from grants from the State. How does revenue recognition differ with the introduction of the new standard?

Under the new revenue (AASB 15) and income (AASB 1058) recognition standards, there is a new hierarchy for revenue/income recognition that may affect the way you recognise revenue from grants received. Depending on the terms of the contracts under which you are receiving grants from the State, you will need to work out the relevant applicable standards, either AASB 15 or AASB 1058 and possibly AASB 1004 also.

You may also want to look at example 8 in AASB 1058

As a NFP we receive a number of grants to provide services to the community. Will we need to recognise these grants as revenue when we receive these? For each grant there is something that we must do - does the revenue get recognised once we perform the item that we must do? As we receive block funding to see many clients, are we going to need to recognise the revenue when each client is seen?

Refer to the previous answer on grant income from the State, the same process will need to apply here. You will need to consider the specific terms and conditions associated with specific grants in determining which standard(s) to apply.

Suggest you also refer to Chart 1 in Appendix B of AASB 1058.

I would like to match my grant revenue to its expenditure. Do these standards allow me to do so?

The standards objective is not to prescribe matching but the practical outcome is that this is now more likely than the previous standards.

A key principle of AASB 15 and the NFP guidance is that revenue is recognised when performance obligations (or promises) are fulfilled. This occurs when the asset or benefit is transferred to a customer or for a NFP, to the beneficiary.

The standard contains some guidance and a number of examples in relation to the requirement that performance obligations be 'sufficiently specific'. In substance the requirements and examples demonstrate that an entity must be able to measure or determine if the promise has been completed.

Importantly the following are not considered sufficiently specific:

- A contract only requiring funds to be spent in a specific period
- A contract only requiring funds for a general purpose or to be spent in accordance with the overall purpose of the entity (e.g. homeless accommodation, counselling, emergency relief etc.).

I have a peppercorn lease. Is the existing accounting (i.e. not recognising them) grandfathered? Or will I have to value it when the new standards apply? And if I have to value it, will I have to employ a valuer?

There is no grand fathering provisions to not apply. Example 14 provides you with details as to how to provide a modified retrospective approach. Practically you will either have to apply based on fair value at when you initially entered into the lease. The alternative is based on the fair value at intitial recognition per example 14. It is likely you will need a specialist to determine fair value. I would discuss this requirement and level of evidence and support with your auditor.

For schools, will a non-refundable enrolment fee received prior to 1 January 2019 be recognised wholly as income in that year or will the portion that relates to a service obligation after 1 January 2019 have to be deferred?

The transitional provisions require retrospective application. This means you will need to calculate as though the standard has always applied. Accordingly, you will need to ascertain enrolment fees for the tenure of existing students (e.g. 13 years if you are a prep – year 12 provider). Materiality does apply so if your fee is more a nominal holding of place fee you may be able to perform a high level calculation to determine the amount would not be material and therefore not apply this requirement.

For larger fees this will be difficult for some in obtaining the information. At least you have until 31 December 2019 to obtain and calculate.

When we adopt the standard from the 1.1.19 - it would be for enrolment fees received for that year even though the child starts in 2020 or is it next year as the child would start 2019?

see response below to above question.

Can the recognition of a donation ever be deferred to the period in which it is spent?

One of the criticisms of the requirements of AASB 1004 was that its application for income like grants often resulted in revenue being recognised when received while the expenses in performing the requirements of the grant would be recognised in later periods. In designing the new standard, the AASB sought to address this issue. Under the new standard income is required to be deferred if certain criteria are met.

I work for a private school. Must we recognise as revenue the volunteer services provided by parents? Also one parent, a plumber provided and installed (all at no cost) air conditioning for 2 portable classrooms. What does AASB 1058 require?

The recognition of volunteer labour at fair value is optional if these services can be reliably measured. We have observed a number of organisations considering recording volunteer labour at fair value. To satisfy the requirements an organisation would need to have adequate systems for recording volunteer labour hours and be able to apply a sound basis of determining the value of such volunteer service. If your accounts are audited, we would recommend you discuss these requirements with your auditor.

In relation to the air conditioners, the standard requires that these be recognised at fair value and recorded as income and an asset addition. In substance this accounting treatment would be the same under the existing standard AASB 1004 and the new Standard AASB 1058.

Our school has a uniform shop. Parents of children leaving the school are strongly encouraged to donate school uniforms for resale. I am hearing that we will need to recognise these donations as revenue. Is that correct?

Typically, all donations including donations of goods are required to be recorded as revenue based on the fair value. The commentary to AASB 1058 confirmed that materiality does apply to such donations in total but rather the assessment of materiality can be performed at the individual donation level. Accordingly, it is likely that organisations like yours and op-shops type operations will not fair value minor donations of goods and they are not required to fair value any stock on hand at the end of the year.