



Project:	Income of Not-for-Profit Entities	Meeting	AASB June 2016 (M152)
Topic:	Transition	Agenda Item:	3.4
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Introduction and objective of this paper

- 1 The objective of this paper is to obtain Board feedback and decisions on the transition requirements for not-for-profit entities, if any, for AASB 15 *Revenue from Contracts with Customers* and [draft] AASB 10XX *Income of Not-for-Profit Entities*.

Background

- 2 AASB 15 applies to existing contracts with customers that are not yet complete as of the effective date of AASB 15 and to new contracts entered into on or after the effective date. All entities that apply AASB 15 (including not-for-profit entities that apply AASB 15) apply the requirements of Appendix C of AASB 15 as amended by AASB 2016-3 *Amendments to Australian Accounting Standards – Clarifications to AASB 15*. Practical expedients for completed contracts and contract modifications are a feature of the transition requirements.
- 3 Appendix C of AASB 15 paragraph C2 notes that for the purposes of its transition requirements "... [a completed contract] is a contract for which the entity has transferred all of the goods or services in accordance with AASB 111 *Construction Contracts*, AASB 118 *Revenue* and related Interpretations.
- 4 For completed contracts, an entity need not restate contracts that are completed contracts at the beginning of the earliest period presented. Without this practical expedient, entities would have to apply AASB 15 as if it had always applied to its contracts with customers.

- 5 The Basis for Conclusions to ED 260 paragraph BC105 notes that the Board concluded that there was no apparent not-for-profit specific reason to depart from the general features of the transitional provisions in AASB 15.
- 6 Appendix C of [draft] AASB 10XX replicates the core transitional provisions in AASB 15. Therefore, the ED proposed that a not-for-profit entity applies the requirements of [draft] AASB 10XX retrospectively using one of two methods:
- (a) retrospectively to each prior reporting period presented in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*;¹ or
 - (b) retrospectively, with the cumulative effect of initially applying [draft] AASB 10XX recognised at the date of initial application.

The practical expedients in Appendix C of AASB 15 apply to completed contracts with customers and modified contracts. As [draft] AASB 10XX does not apply to contracts with customers, Appendix C of [draft] AASB 10XX does not replicate them.

Feedback received

- 7 Most constituents did not support the transitional proposals – with many concerned that the proposals were not practical. One constituent was concerned with the implications for existing research, donation and grant funded projects. Some constituents expressed their concerns about the implications for “peppercorn” and noted that often the leased asset was provided with conditions that restricted its use. Therefore, whether the terms of a “peppercorn” lease were truly concessional was arguable. Some constituents were of the opinion that the transition provisions should include an option of applying an approach similar to that adopted on first-time transition to Australian Accounting Standards (i.e., a deemed cost approach). One constituent supported a prospective approach. Fair value at the beginning or end of the first annual reporting period to which [draft] AASB 10XX is applied may be an option.

AASB 15 transition relief

- 8 AASB 15 applies to contracts with customers. Appendix C of AASB 15 contains a ‘definition’ of a completed contract. In effect, on transition to AASB 15 a completed contract exists when at the beginning of the earliest period presented, the revenue of a transaction has already been fully recognised from applying AASB 111 and AASB 118. Appendix C of AASB 15 does not refer to AASB 1004 *Contributions*. Therefore on transition to AASB 15, a transaction where, at the beginning of the earliest date presented, revenue has already been fully recognised by a not-for-profit entity from applying AASB 1004 *Contributions* is not a completed contract. Without access to the practical expedient the not-for-profit entity would apply AASB 15 as if it had always applied to its contracts with customers During outreach staff heard that

¹ AASB 15 Appendix C paragraph C3 (a) refers to a practical expedient for retrospective application of its requirements. The reference to the practical expedient and the related paragraph are excluded from [draft] AASB 10XX as they affect contract balances.

some not-for-profit entities are of the view that some of their open arrangements including some endowments in existence for 20 or 30 years could be within the scope of AASB 15. They noted that if AASB 15 applied they would not be able to take advantage of the completed contracts expedient in Appendix C of AASB 15 as they did not satisfy its criteria for a completed contract – as AASB 1004 is not on the list. Constituents identified the time and effort to examine each of about 100 open contracts. One respondent to ED 260 believed they had many thousands of arrangements that would require analysis.

- 9 To respond to the concerns raised by constituents, staff recommend that Appendix C of AASB 15 is amended to include an ‘Aus’ paragraph that for not-for-profit entities “a completed contract is a transaction for which the entity has recognised all of the revenue in accordance with AASB 1004 *Contributions*.”

Question for Board members

- Q1 Do Board members agree with the staff recommendation that Appendix C of AASB 15 be amended to include an ‘Aus’ paragraph that for a not-for-profit entity “a completed contract is a transaction for which the entity has recognised all of the revenue in accordance with AASB 1004 *Contributions*?”

Transition relief for assets acquired at no cost or nominal consideration

- 10 AASB 1004 paragraph 11 requires contributions of assets to initially be measured at the fair value of the contributed asset with a corresponding amount recognised as income in the statement of financial performance. Staff note that this requirement to initially measure the contributed assets at fair value is consistent with the “Aus” paragraphs in some existing Australian Accounting Standards. AASB 116 *Property, Plant and Equipment* paragraph Aus15.1 states “...in respect of not-for-profit entities, where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition.”. AASB 138 *Intangible Assets* includes the same wording at paragraph Aus24.1.
- 11 Staff are of the view that no impact would be expected on transition to AASB 10XX if a non-financial asset is being accounted for under the revaluation model because the asset’s closing balance for the immediately preceding period would be materially the same as fair value.
- 12 Staff note that the AASB 1004 requirement to measure the asset at fair value is different from the requirements of the leasing standards (AASB 117 *Leases* and AASB 16 *Leases*). Staff understand that there will be occasions where some not-for-profit entities have on initial recognition of the asset in the lease not measured it at an amount that is fair value (when there are no lease payments or the lease payments are of a nominal amount). Appendix C of [draft] AASB 10XX effectively proposes requiring the not-for-profit entity to initially apply [draft] AASB 10XX fully retrospectively and remeasure the asset’s initial carrying amount as if it had been measured at fair value on initial recognition.
- 13 For example if a not-for-profit entity’s “peppercorn” 99 year lease of a building commenced thirty years ago, Appendix C of [draft] AASB 10XX would require that the entity to determine the fair value of the leased property at the commencement of

the “peppercorn” lease and any subsequent accumulated depreciation and accumulated impairment losses, to measure the opening balance of that asset on initial application of [draft] AASB 10XX – except to the extent this is impracticable (AASB 108).

- 14 Appendix C of [draft] AASB 10XX does not include practical expedients for lease accounting. In contrast, the Appendix C transition requirements of AASB 16 include a practical expedient to not require a reassessment of whether a contract is, or contains, a lease at the date of initial application. Instead:
- (a) a lessee is not required to apply AASB 16 to contracts that were not previously identified as containing a lease applying AASB 117 or Interpretation 4 *Determining whether an arrangement contains a lease* (paragraph C3(b)); and
 - (b) a lessee applies AASB 16 to contracts that were previously identified as leases applying AASB 117 and Interpretation 4 (paragraph 3(a))²:
 - (i) retrospectively to each prior reporting period presented in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*;³ or
 - (ii) retrospectively, with the cumulative effect of initially applying [draft] AASB 10XX recognised at the date of initial application and use one or more of the practical expedients in Appendix C of AASB 16.
- 15 Staff consider that the order in which the AASB 117 and AASB 1004 requirements have been applied is highly relevant to the operation of the practical expedients on transition to AASB 16. At the July 2011 Board meeting the Board discussed the order in which the AASB 117 and AASB 1004 requirements could be applied. The Board did not make any decisions. Three alternatives were discussed by the Board. In the context of the issue of transition to AASB 16 the three alternatives can be categorised as two views:
- (a) View 1-Not previously identified as a lease under AASB 117: the requirements of AASB 1004 prevail over the requirements of AASB 117 – the contribution is accounted for as a grant of an asset. That is, lessees apply the recognition and measurement requirements of AASB 1004; or
 - (b) View 2-Previously identified as a lease under AASB 117:

² The lessee applies AASB 16 to its leases retrospectively using one of two methods:

- (a) retrospectively to each prior reporting period presented in accordance with AASB 108 or
- (b) retrospectively, with the cumulative effect of initially applying AASB 16 recognised at the date of initial application in accordance with paragraphs C7-C13 of AASB 16, which include other practical expedients. Comparative information is not restated. Instead the lessee recognises the cumulative effect in the opening balance of retained earnings on the date of initial application.

³ AASB 15 Appendix C paragraph C3 (a) refers to a practical expedient for retrospective application of its requirements. The reference to the practical expedient and the related paragraph are excluded from [draft] AASB 10XX as they affect contract balances.

- (i) the requirements of AASB 117 prevail over the requirements of AASB 1004. That is, lessees apply the recognition and measurement requirements of AASB 117. For an operating lease, no expense would be recognised as there are no lease payments. For a finance lease, no asset or liability would be recognised as the present value of minimum lease payments is nil.⁴ Note that this accounting would result in a similar outcome to AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* if the principles in the Standard were to be applied and the nominal amount option in paragraph 23 of that Standard were adopted.; or
- (ii) Previously identified as a lease under AASB 117: the requirements of AASB 1004 apply in the context of the requirements of AASB 117. That is, lessees apply the recognition requirements of AASB 117 and the measurement requirements of AASB 1004. For an operating lease, income (and expense) would be recognised for the value of each reporting period's lease benefits received (and consumed) while conforming to AASB 117's prohibition of lessees recognising lease assets in respect of operating leases. For a finance lease, a right of use asset would be recognised, consistent with AASB 117, with corresponding income measured at fair value of the right of use asset, consistent with AASB 1004.

- 16 A not-for-profit entity that had applied View 1 to its accounting for “peppercorn” leases would be unable to make use of the practical expedient in AASB 16 to continue its accounting policy for existing “peppercorn” leases. A not-for-profit entity that had applied View 2 to its accounting for “peppercorn” leases cannot access the other practical expedients in AASB 16.
- 17 The staff view is that Appendix C of [draft] AASB 10XX should replicate all of the practical expedients in AASB 16. The Project Advisory Panel in its discussions with staff on this issue agreed.
- 18 In addition to replicating the transition relief from AASB 16, given the existing uncertainty over the correct order for applying the requirements of AASB 117 and AASB 1004 staff have identified three alternatives for ‘grandfathering’ existing “peppercorn” leases:
- (a) AASB 10XX only applies to transactions entered into on or after the date of issuance of AASB 10XX (i.e. no change to accounting for existing “peppercorn” leases).
 - (b) the lessee measure the carrying amount of the right-of-use asset (and the resulting lease liability) at the date of initial application of AASB 10XX at the existing carrying amount of the lease asset and lease liability immediately before that date.

⁴ Assuming there are no nominal amounts payable.

- (c) the lessee measure the carrying amount of the right-of-use asset and the lease liability at the date of initial application of AASB 10XX at the fair value is deemed cost at transition.

The staff view is that a ‘grandfathering’ provision be applied on a lease-by-lease basis.

- 19 The effective date of AASB 10XX is expected to be 1 January 2018. Given that the issuance of the final Standard is expected to be December 2016, staff recommend that restatement of comparative information not be required in the first year of application.

Questions for Board members

- 2(a) Do Board members agree with the staff view that Appendix C of [draft] AASB 10XX replicate all the practical expedients in AASB 16?
- 2(b) Do Board members wish to provide transitional provisions in [draft] AASB 10XX to “grandfather” the entity’s existing accounting for “peppercorn” leases? If so, which transitional provisions does the Board wish to provide?
- 2(c) Do Board members agree that comparative information not be required in the year of first application?