HOW SPECIFIC IS "SUFFICIENTLY SPECIFIC?"

Applying AASB 1058 *Income of Not-for-Profits* and *AASB 15 Revenue from Contracts with Customers*

AASB 1058 *Income of Not-for-Profits* became applicable for not-for-profit entities on 1 January 2019. In a previous article, we provided insights into application of the new Standard.

In this article, we consider common challenges – and how to address them – when identifying the appropriate standard to apply to recognise income from grants.

How to determine which standard applies to an income source?

A not-for-profit entity must assess whether every funding source received meets the criteria to be recognised under AASB *15 Revenue from Contracts with Customers* (AASB 15) or whether it is captured by *AASB 1058 Income of Not-for-Profits* (AASB 1058).

Usually, it is easier to consider first whether AASB 15 applies to the entire funding source, noting the specific guidance applicable for Not-for-Profit entities in AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* (AASB 2016-8). If AASB 15 does not apply, then the applicable standard will usually be AASB 1058.

For every source of funding received, not-for-profits must contemplate the following question:

> ***Is there a contract with a customer to transfer specific goods or services to the funder (or to a third-party beneficiary as directed by the customer)?***

If an entity does not have to deliver sufficiently specific goods or services to the funder (or to a third-party beneficiary if it is specified within the contract), in order to be entitled to the income, then the entity is not providing consideration worth 'the fair value' of the cash received, which means that AASB 15 does not apply and the relevant standard to apply is AASB 1058. (AASB 1058.B5)

This is important, because the default position of AASB 1058 is that income is recognised immediately regardless of when the related expenses are incurred.

This highlights an issue of significant judgment: *what is a sufficiently specific performance obligation* in the context of AASB 15?

What does "sufficiently specific" mean?

Performance obligations

A performance obligation is a distinct promise to transfer goods or services to a customer, or to a third-party beneficiary if this is specified by the customer.

While these are often easy to identify for most for-profit entities, there is often judgment involved in identifying whether promises in an agreement in a not-for-profit entity are distinct performance obligations, and then more importantly, whether they are *sufficiently specific* so as to be able to determine when the obligation is satisfied (AASB2016-8.F20).

"Sufficiently specific"

Assessing whether a performance obligation is sufficiently specific involves considering whether the entity can determine, for each separately identified performance obligation:

- The specific type or nature of goods or services to be delivered
- The specific cost or value of the goods or services to be delivered
- The specific quantity of goods or services to be delivered
- The period of time over which the goods or services must be transferred

A performance obligation is only sufficiently specific if an entity can determine when it has met that obligation, which means that the performance obligation must refer to specifically identifiable goods or services, and ultimately, be measurable.

Guidance in the standards

The standards include guidance to help entities determine whether or not a contract contains sufficiently specific performance obligations, including:

- The existence of a clause specifying the **period of time** during which goods or services must be transferred is not, by itself, enough to indicate that a contract contains a sufficiently specific performance obligation.
- A NFP with a **single charitable objective** is not enough to determine that funding to support its charitable objectives meets the 'sufficiently specific' criteria.
- The existence of an **acquittal process** is not on its own enough to say that a contract contains sufficiently specific performance obligations, though if the entity is required to demonstrate which performance obligations have been satisfied in each acquittal, then it may do.
- Specific purchases or activities the NFP must undertake in order to satisfy a performance obligation (e.g. promotion of an event, where running an event is the performance obligation) are not themselves separate performance obligations

While not all of the factors above must be present in an agreement to determine performance obligations as being sufficiently specific, and all the facts and circumstances of the agreement must be considered, if an entity would not be able to identify the point at which it has completed its obligation, the obligation is not sufficiently specific.

This is important because, if the obligations in an agreement are not sufficiently specific to determine when they have been fully met, then the agreement is not practically enforceable, and therefore the income must be recognised under AASB 1058. This will usually result in recognising income on receipt. Under AASB 15, revenue would usually be recognised over time, or on completion of the performance obligation, with income received in advance being deferred.

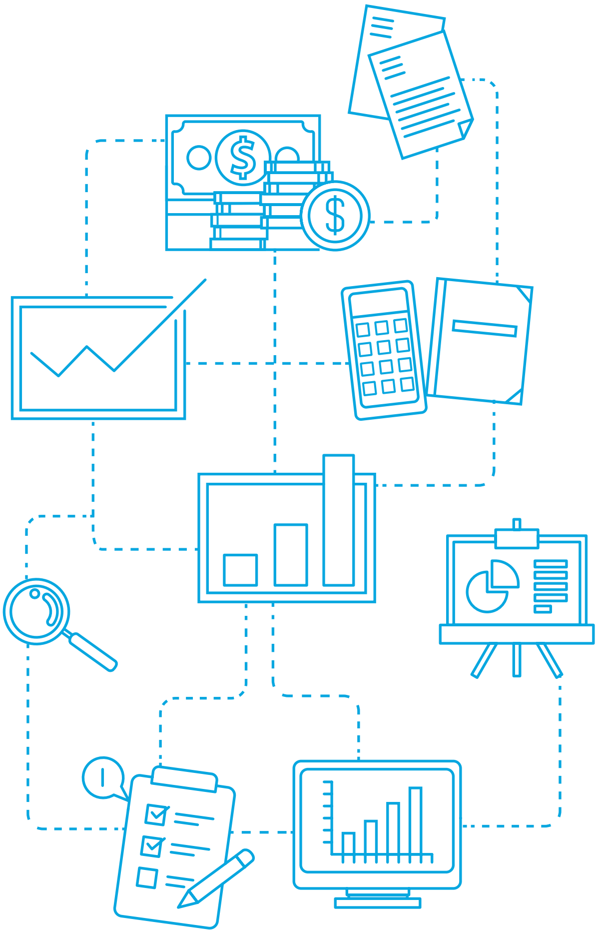
Applying these requirements in practice is complex, so we provide below illustrative examples to help.

ILLUSTRATIVE EXAMPLES: ABRACADABRA, A NOT-FOR-PROFIT

The following examples all relate to the Not-for-Profit 'Abracadabra', which runs a design and technology camp for children from disadvantaged backgrounds to encourage their participation in STEM subjects, and provide an environment which fosters creativity and an appreciation for the arts

Abracadabra's activities are funded primarily through the following sources:

- The **Department of Magical Education's** recurring funding for the continued operation of Abracadabra, of $3,000,000 for a period of 3 years
- A grant from **Harry's Charitable Foundation**, totalling $500,000
- A grant from **The Moon Association** totalling $100,000



IllUSTRATIVE EXAMPLE 1
DEPARTMENT OF MAGICAL EDUCATION

EXAMPLE 1: Abracadabra's three-yearly grant from the Department of Magical Education

The terms of this grant are as follows:

- Total funding value: $3,000,000
- The funding is for a period of 3 years
- The funding is to enable Abracadabra to run camps for the benefit of disadvantaged children, but no minimum number of camps or children is specified
- If the funding is not wholly expended in a 3-year period, it is repayable to the Department, unless the Department agrees to waive the repayment clause
- Annual updates and acquittals which demonstrate that funds have been spent on running the camps must be provided to the Department

Abracadabra concludes that the agreement is enforceable, as the grant is refundable if the camps are not run. However it is not a contract with a customer as defined in AASB 15, because:

- Running an indeterminate number of camps for an indeterminate number of children over a 3-year period is not sufficiently specific to enable Abracadabra to identify when it has satisfied its obligations under the agreement
- The annual updates and acquittals only provide the Department with evidence of the spending of funds, and *do not transfer a benefit to the funder or to any third-party beneficiaries*

Accounting treatment
Abracadabra recognises this income under AASB 1058. First, Abracadabra recognises the cash when received, and then the entity considers whether there are any related amounts under other standards. Since none are identified, Abracadabra recognises $3m in income on receipt.

Impact
This treatment may mean that internal reporting and budget monitoring will likely differ to financial reporting under Australian Accounting Standards.

- For budgeting purposes, Abracadabra had allocated $1m per year as revenue, but income in the financial report will show $3m in year one, and $0 in each of the 2 subsequent years
- For the acquittal process, the funder has requested to see how yearly income is expended, so a reconciliation between the figures in the financial report and the figures reported in the acquittal documentation will likely be required

IllUSTRATIVE EXAMPLE 2
HARRY'S CHARITABLE FOUNDATION

EXAMPLE 2: Abracadabra's grant from Harry's Charitable Foundation

Abracadabra applied for a grant which aimed to support NFPs working with disadvantaged children. In its application for the grant, Abracadabra provided a work plan which identified how it would use the funding if successful.

In its application, Abracadabra noted that the funding would be used to:

- Improve the participation in the camps by orphaned children, by:
  - Increasing the promotional activities of Abracadabra
  - Tailoring its messaging for children from diverse backgrounds
- Provide additional resources to better support the care of identified at risk children during the camps

It included the following benchmarks that it would report on:

- Number of advertising campaigns on social media
- Number of meetings held at schools to talk about the camps
- Numbers of children attending each camp before the campaign, and after the campaign

The funding was granted on the following terms:

- Total funding value: $500,000
- Funding term: 2 years
- Quarterly reports to be made to the Foundation, including reporting the data specified in the benchmarks, and the spend of funds on running the camps
- Any unspent funds would be returned at the end of the term

Abracadabra concludes that the agreement is enforceable, as the grant is refundable if it is not wholly spent. However it is not a contract with a customer as defined in AASB 15, as there are no specific performance obligations:

- The 'performance measures' the entity reports on are not performance obligations: they will allow the entity to demonstrate to the Foundation that it is using the funding, but they do not transfer a benefit to the funder or to third parties as directed to by the funder
- The quarterly reporting only provides the Foundation with evidence of the spending of funds, and do not transfer a benefit to the funder or to any third-party beneficiaries.

Accounting treatment
Abracadabra recognises this income under AASB 1058. First, Abracadabra recognises the cash when received, and then the entity considers whether there are any related amounts under other standards. As none are identified, Abracadabra recognises $500,000 as income on receipt of the funding.

IIUSTRATIVE EXAMPLE 3
THE MOON ASSOCIATION

EXAMPLE 3: Abracadabra's grant from The Moon Association

Abracadabra also applied for a grant which was advertised by The Moon Association, providing in its application a work plan which identified how it would use the funding if successful.

In its application, Abracadabra noted that the funding would be as follows:

- During each of the 20 camps it runs per year, Abracadabra will run a design challenge to design a Space Station, with the winning design being built up as a scale model, and presented at the Capital City Science Fair
- More specifically, the funding will be used for:
  - Upgrading the design software on every computer that the children would use (60 computers, so 60 licences required)
  - Purchasing all materials required to model the winning space stations designed in each camp
  - Pay for transport to Capital City for the winning team and accompanying adults, for each camp session

The funding was granted on the following terms:

- Total funding value: $100,000
- Funding term: 1 year
- Quarterly reports to be made to the Association with management accounts showing evidence of spend of funds
- Any unspent funds would be returned at the end of the term of the grant

Abracadabra concludes that the agreement is enforceable, as the grant is refundable if it is not wholly spent. In addition, there is one specific performance obligation to be delivered: *Running 20 Space Station challenges in a year.*

Although the performance of those obligations do not represent services provided to the funder (who is not a beneficiary of the services) they are obligations provided for the benefit of third parties (the children).

The purchase of materials to run the design challenges are not on their own performance obligations; but rather inputs into the delivery of the challenges. They are activities undertaken to fulfil a contract, which do, by themselves not transfer any goods or services to the customer.

Accounting treatment

Therefore, in accordance with AASB 15, Abracadabra allocates the cash grant to its identified performance obligation, and recognises the financial asset (cash) and a contract liability of $100,000 on initial recognition.

Abracadabra concludes that the beneficiaries (rather than the donor) simultaneously receive and consume the benefits of the challenge as is run, as another entity would not need to substantially re-perform the portion of the challenge completed by Abracadabra if the other entity were to fulfil the remaining performance obligation, based on the nature of the challenge days.

Abracadabra concludes that the recognition as each camp is run best represents the pattern transfer of benefits to the beneficiaries, and therefore would recognise $5,000 on each of the 20 challenge days.

For further information, please contact Ralph Martin National Technical Director, Ana Espinal-Rae or your local RSM advisor.

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