
# NEW INCOME RECOGNITION RULES IN THE NOT-FOR-PROFIT SECTOR

In December 2016, the AASB issued AASB 1058: Income for not for profit entities. The new standard is applicable for periods beginning on or after 1 January 2019, and the AASB has made complementary changes to the existing AASB 1004 Contributions, and has also added new guidance AASB 15 Revenue from Contracts with Customers to clarify its application in the not for profit sector. Early adoption is permitted, provided that AASB 15 is adopted simultaneously.

## INTRODUCTION

The new standard was the result of a long-running project to address the ambiguity and inconsistent application of AASB 1004. It applies not only to donations, but to any transaction where no consideration was paid, or where the consideration given to acquire an asset is significantly less than the fair value of that asset. It also introduces new rules in respect of the recognition of volunteer services.

## KEY REQUIREMENTS

- In order to be within the scope of AASB 1058, a transaction must involve the acquisition of an asset by a not-for-profit entity for a payment that is significantly less than its fair value. What is considered "significantly less" than fair value will be a determination that requires judgment, but it would typically include grants, bequests, donations, or other similar voluntary contributions.

- AASB 1058 establishes a new model for the receipt such an asset for nil or discounted consideration by a not-for-profit entity. The asset received (whether it is cash or a non-financial asset) will be recognised in accordance with the relevant Australian Accounting Standard. Where the other side of the entry is made will depend on the nature and terms of the transaction:
  - Amounts that are transferred without any 'strings attached' may be recognised as income immediately.
  - If the funds received have 'performance obligations' attached, then the amount is recognised as revenue in accordance with the principles of AASB 15, which would mean recognising the proportion relating to these obligations as income only when they are satisfied. This applies regardless of whether the beneficiary of the activity is the same entity that gave the grant.

### EXAMPLE

A local children's group receives a grant from the State government with a specific requirement to operate a playgroup over the next 12 months. This would be considered a performance obligation, and income would therefore be recognised as the obligation is met, which would likely be on a pro-rata basis over the 12 months.

  - Some arrangements may have both a performance obligation, and a non-performance element, which should be accounted for separately.

## EXAMPLE

An electronics retailer decides to provide a local children's hospice with new TVs and games consoles at a heavily discounted price. The equipment would normally retail for $5,000, but the retailer offers it for just $1,500, as a method of supporting the hospice. In this example, the hospice would recognise the equipment as a non-current asset with a value of $5,000. The difference between this and the amount paid would be recognised as donation income of $3,500.

- Donated goods must be recognised at their replacement cost, if material. If they are considered immaterial, they need not be recognised as inventory.
- Grants made to enable a not-for profit entity to buy or construct an asset are only recognised when the obligations to do so are met.
- Certain entities in the government sector will be required to recognise the fair value of time provided by volunteers as income. This requirement only applies where:
  - The fair value of the services provided can be reliably measured
  - The services in question would have been purchased if they had not been donated.

## EXAMPLE

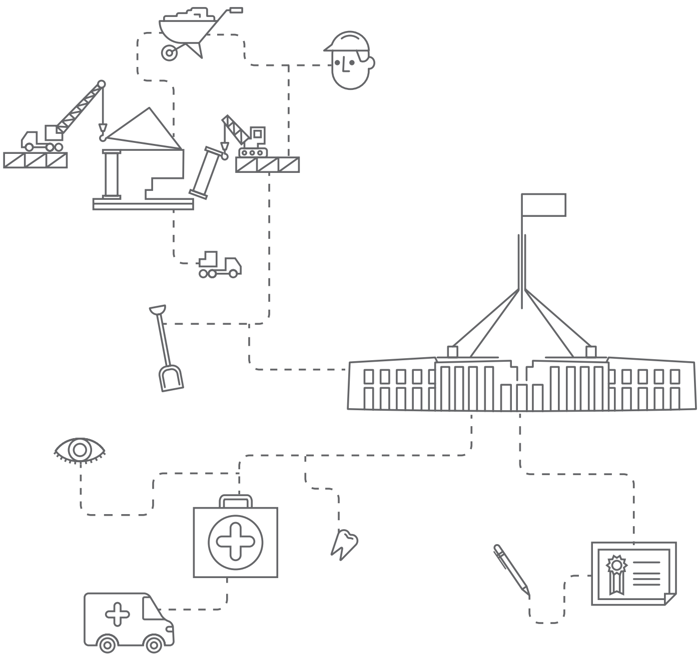
A charity receives a government grant of $2m to establish a shelter for the homeless in a particular city. At the point at which the funds are received, it must recognise cash of $2m, and a liability, being its performance obligation, of $2m. It may only recognise the $2m as income when the building is purchased or constructed, and therefore the performance obligation is met.

- AASB 1058 gives all other not-for-profit entities the option to elect to recognise volunteer services on this basis. However, this is not mandatory, and we believe that most not-for-profit entities will choose not to apply it.

## IMPACT

The existing AASB 1004 Contributions could require income to be recognised when received, regardless of the fact that there were unmet performance obligations to third parties associated with the grant. This could result in a mismatch between the recognition of revenue and the related expenses, for example when a grant was received before year-end, but the programme on which it was spent was enacted in the following financial year. AASB 1058 should end this mismatch and result in a greater consistency of when revenue and expenses are recognised.

However, not-for-profit entities will need to exercise judgment in applying the new standard. This will occur both in determining whether transactions are at fair value or not, and in determining what performance obligations are attached to their income, and whether they are met. We recommend that not-for-profit entities consider carefully their existing arrangements and the likely impact of these new standards as soon as practicable.



For further information please contact Ralph Martin or your local RSM practitioner.

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