Implementing the New Generation of Revenue Accounting Standards

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WHAT WE WILL COVER TODAY:

How do I apply AASB 1058?

Understanding how AASB 15 interacts with AASB 1058

“Enforceable and Sufficiently Specific” in practice

Licence revenue in the public sector

Transitional Considerations and Grant Expenses
Do you remember when…???

Pop Quiz – Can you guess the year?

• Intel launch 386 processor
• “You’re the Voice” spends 7 weeks at No.1
• Space Shuttle Challenger explodes 73 seconds after take-off
• Chernobyl nuclear disaster
• The Gateway Bridge is opened
Pop Quiz – Can you guess the year?

- “The Locomotion” spends 7 weeks at No.1
- First Rugby World Cup tournament was held
- US President Ronald Reagan challenges Soviet leader Mikhail Gorbachev to “tear down this wall”
- The Dow Jones fell 22.61% in a single day known as “Black Monday”
Do you remember when…???

1986 – saw the birth of:
- AASB 1004 “Disclosure of Operating Revenue”
- AAS 15 “Disclosure of Operating Revenue”

1987 – saw the birth of:
- AASB 1008 “Leases”

Gen Y gave rise to The Millennials (IFRS) then…
MEET “GENERATION ALPHA”

- Accounting Standards for a new generation -
  - AASB 1058: Income of Not-for-Profits
  - AASB 15: Revenue from Contracts with Customers
  - AASB 9: Financial Instruments
  - AASB 16: Leases
  - AASB 1059: Service Concession Arrangements
Where does my revenue land within this new generation?

- Appropriations
- Grants—Recurrent
- Grants—Special purpose
- Grants—Capital
- Fees
- Levies
- User charges
- Fees for service
- Sale of goods
- Licences
- Royalties
- Performance management fees
- Contributed services
- Developer contributions / contributed assets
- Sponsorship
- Rates and fines
- Taxes
- Interest
- Dividends

Legend:
- AASB 1058 (or AASB 1004)
- AASB 1058/AASB 15
- AASB 9 – statutory receivables
- AASB 9 – finance revenue
When and How do I Apply AASB 1058?
When and how do I apply AASB 1058?

• First – what’s NOT in scope?

(a) share-based payment transactions within the scope of AASB 2 Share-based Payment;
(b) business combinations within the scope of AASB 3 Business Combinations;
(c) insurance contracts within the scope of AASB 4 Insurance Contracts, AASB 1023 General 
   Insurance Contracts or AASB 1038 Life Insurance Contracts;
(d) licences outside the scope of AASB 15;
(e) income taxes within the scope of AASB 112 Income Taxes; and
(f) restructures of administrative arrangements within the scope of AASB 1004.

• Note: AASB 1004 still exists but no longer deals with revenue
When and how do I apply AASB 1058?

• AASB 1004 continues to exist after AASB 1058 becomes effective;

• Only contains requirements for:
  - equity contributions and distributions;
  - appropriations that meet definition of equity;
  - restructures of administrative arrangements; and
  - liabilities of departments assumed by other entities.

• So AASB 1058 may point you to AASB 1004…
When and how do I apply AASB 1058?

- AASB 1058 applies to NFP entities only.
- Effective 1 January 2019 – most agencies first apply FY2020.
- 31 December reporters have less than 6 weeks to year-end.
- Replaces AASB 1004 Contributions for revenue recognition.
- Applies to:
  - Certain qualifying transactions; and
  - Volunteer Services.
- **If you are a NFP entity – THIS IS YOUR START POINT**
Practically speaking, AASB 1058 is the starting point for all NFPs irrespective of whether they obtain the asset significantly below fair value or not.

AASB 1058 will refer you to the appropriate standards.

E.g. The sale of inventory or rendering of services under a fee-for-service contract will fall under AASB 15, NOT AASB 1058.
When and how do I apply AASB 1058?

• AASB 1058 applies to a transaction where:
  ➢ the **consideration** to acquire an **asset** (including cash);
  ➢ is **significantly less** than the asset’s **fair value**;
  ➢ and the **difference** between the two is principally to enable the entity to **further its objectives**.
When and how do I apply AASB 1058?

Fair value of the asset acquired \(a\)

\[\text{minus}\]

Consideration provided \((-b)\)

\[\text{equals}\]

Difference \(c\)
When and how do I apply AASB 1058?

• Give me an illustration…

   ➢ An entity that receives a cash grant to be used to further its objectives might not have provided any consideration in exchange for that cash.

   ➢ Governments are entitled to non-contractual receivables arising from statutory requirements such as taxes and rates without providing consideration to the other party – those receivables provide income to the government to further its objectives.
When and how do I apply AASB 1058?

- AASB 1058 does not specify what constitutes “significantly less” than fair value.

- As a indicative guide – not “bright lines” or “mandatory policy”:
  - if the difference between the asset's fair value and the consideration provided is 15% or more, then “significantly less” test needs to be examined closely.
  - if the difference between the asset's fair value and the consideration provided is 30% or more, then the AASB 1058 “significantly less” test is more likely than less likely to be met.

- A “trade discount” or “distress sale” is not principally related to furthering the entity’s objectives.
When and how do I apply AASB 1058?

**STEP 1** – RECOGNISE THE DEBIT SIDE OF THE ENTRY

(i.e. account for the asset as per the relevant Standard).

Implementing the New Generation of Revenue Accounting Standards – IAG November 2019
When and how do I apply AASB 1058?

**STEP 2 – RECOGNISE THE CREDIT SIDE OF THE ENTRY**

(i.e. account for the “related amounts” as per the relevant Standard).
When and how do I apply AASB 1058?

STEP 3 - RECOGNISE THE REMAINING AMOUNT IN REVENUE IMMEDIATELY
When and how do I apply AASB 1058?

- **Volunteer Services** – 2nd area covered by AASB 1058
  - Local governments, government departments, general government sectors (GGSs) and whole-of-governments must:
    - Recognise volunteer services received as income where the fair value of the services can be measured reliably; and
    - the services would have been purchased if they had not been donated.
  - The debit side of the transaction would be to an expense or an asset, as appropriate.
  - No change to current Queensland Treasury FRR policy.
When and how do I apply AASB 1058?

• Are you a Queensland Government Agency that acts as the PROVIDER of volunteer services??

• **DO NOT ACCOUNT** for the volunteer services provided.

• Effectively double counting in the providers books.

• **Only the recipient** accounts for volunteer services. FRR 3B.3 applies to recipient only
Understanding how AASB 15 interacts with AASB 1058
In summary, to defer recognition of grant income, agencies will no longer need to demonstrate they are directly giving approximately equal value back to the grantor.
Understanding how AASB 15 interacts with AASB 1058

Q. “AASB 15 allows us to defer grant revenue right?” A. It depends!!

• AASB 1058 para. 9(b) “An entity shall recognise any related amounts for revenue or a contract liability arising from a contract with a customer, in accordance with AASB 15.”

• Two questions –

• Does the transaction occur in a contract with a customer that creates enforceable rights and obligations?

• Does the contract include ‘sufficiently specific’ performance obligations (promises by the NFP to transfer goods/services to the customer)?

• We now go back to AASB 15 to find out!!!
Understanding how AASB 15 interacts with AASB 1058

STEP 2 – RECOGNISE THE CREDIT SIDE OF THE ENTRY

(i.e. account for the “related amounts” as per the relevant Standard).
Understanding how AASB 15 interacts with AASB 1058

AASB 15 Appendix F “Australian implementation guidance for not-for-profit entities”

Provides guidance to assist not-for-profit entities in relation to identifying a contract and identifying performance obligations.

Integral part of AASB 15
Understanding how AASB 15 interacts with AASB 1058

- If either of the 2 criteria are **not met** – AASB 15 **will not apply** to the contract and the AASB 1058 continues to be applied to the transaction.
Understanding how AASB 15 interacts with AASB 1058

• **Transfers of financial assets (grants) to construct a non-financial asset controlled by an entity** –

• No obligation for the NFP to transfer the asset to the grantor or another parties.

• The entity must control the constructed non-financial asset.

• Not a contract with a customer under AASB 15;

• Accounted for under AASB 1058, paragraphs 15-17.

• Deferral of revenue recognised over asset’s construction.

• **THIS DOES NOT APPLY TO CAPITAL FUNDING PROVIDED BY EQUITY APPROPRIATION!!**
Understanding how AASB 15 interacts with AASB 1058

Is the cash received for acquiring or constructing a non-financial asset to be controlled by the NFP? (and not an equity contribution)

Yes → AASB 1058 (para. 15-17) applies

No

Does the transaction occur in a contract with a customer that creates enforceable rights and obligations?

Yes

Does the contract include 'sufficiently specific' performance obligations (i.e. promises by the NFP to transfer goods/services to the customer)?

Yes → AASB 15 applies

No → Fails AASB 15 criteria for deferral - AASB 1058 applies

No

As a high-level summary – this flow chart is handy…

But we always recommend using the decision tree flowchart in AASB 1058

Work through accounting for the asset and the related ‘credit’ amounts to ensure correct accounting is achieved – and where multiple ‘related amounts’.
“Enforceable and Sufficiently Specific” in practice
“Enforceable and Sufficiently Specific” in practice

Enforceability

• Agreements can still be legally enforceable even if they are not in the form of a formal contract, such as Memoranda of Understanding, Heads of Agreements and Letters of Intent.

• Statements of intent to spend money or use assets in particular ways are in the nature of public policy statements - they do not by themselves create enforceable agreements. (e.g. budgets and service delivery statements).

• Third party beneficiaries who receive the goods and service generally cannot enforce the agreement as they are not parties to the agreement. Those third parties may have certain rights under enacted legislation, however those rights exist independently from the agreement between the grantor and the recipient agency.
“Enforceable and Sufficiently Specific” in practice

Enforceability

• The requirement to refund grant monies if they had not been spent on specified performance obligations is often an indicator of an enforceable agreement.

• Enforceability is assessed on the grantor’s capacity and rights to enforce. It is not relevant that the grantor has historically not enforced similar agreements (e.g. not asking for refunds).

• It is an indicator of enforceability if the grantor can reduce future funding to which the agency is presently entitled, effectively the grantor is choosing to settle the refund in net.

• However, withholding of future funding to which the agency is not presently entitled does not demonstrate enforceability.
“Enforceable and Sufficiently Specific” in practice

**Sufficiently Specific**

- A contract with a customer includes promises to transfer goods or services to the customer. If those goods or services are *distinct*, the promises are performance obligations and, under AASB 15, must be accounted for separately.

- In a not-for-profit context, identifying distinct promises or even the **total goods or services to be provided** can often be difficult.

- Some NFP contracts include detailed descriptions of specific deliverables
  - (e.g. provide 5,000 hours of counselling to victims of violence)

- Many others include more ‘aspirational’ or mission/charter/objectives statements
  - (e.g. provide 24/7 telephone access for medical advice in remote areas.)

- Everything in between…
“Enforceable and Sufficiently Specific” in practice

**Outputs**
Ordinarily will be sufficiently specific
Typically measurable
We can determine when promise has been satisfied or delivered

**Activities**
“The grey area”
Can you tick off / measure when a promise has been delivered/satisfied?
Maybe at the end of the agreement?
May be a combination of ‘sufficiently specific’ and not ‘sufficiently specific’

**Objectives**
Ordinarily will FAIL the sufficiently specific test
Not Measurable
Unable to determine when the promise has been satisfied
“Enforceable and Sufficiently Specific” in practice

**Sufficiently Specific**

- The overarching principle a promise cannot be ‘sufficiently specific’ unless we are able to determine when the promise in the contract has been satisfied.

- For performance obligations to be sufficiently specific, the agency must be able to determine *when (or to what extent) the obligation is satisfied*, in order to work out when and how to recognise revenue.

- To have sufficient specific performance obligations, the goods or services to be provided must be specified by or determinable in accordance with the agreement; they must not be at the discretion of the recipient.

- Paragraphs F20-F27 in Appendix F AASB 15
What IS NOT ‘Sufficiently Specific’

- General statements of intent
- An obligation to merely ‘spend money’ in line with mission/objectives
- A period of time by itself, with no other factors from paragraph F20. (e.g. during a particular year)
- We are unable to measure progress towards satisfying the obligation. This is usually the case when the goods/services to be provided are unspecified, unquantifiable, or is at the discretion of the agency.
- Examples: Undertake education programs over 3 years to increase the literacy of students in a specific rural area OR provide free student accommodation for one student each year, for as long as the university operates.
What IS NOT ‘Sufficiently Specific’

- Some agreements require an acquittal process whereby the NFP is required to show how monies received have been spent.

- If the acquittal process details which performance obligations have been satisfied or the progress status, this may provide evidence that the promises are ‘sufficiently specific’.

- Periodic progress reporting may also assist agencies with measuring its progress towards satisfying performance obligations.

- However, **such reporting obligations are not considered separate performance obligations themselves.**
Questions you should be asking:

• What is the purpose of the funding?

• Are there mechanisms for authorised or eligible expenditure?

• What are the identified promises and/or key performance indicators?

• Are there **linked refund obligations** for not meeting the performance obligations and/or key performance indicators?

• If not, are they really performance obligations?
“Enforceable and Sufficiently Specific” in practice

Questions you should be asking:

- Is there a transfer of goods and services?

- What are the distinct goods or services being transferred (performance obligations)? – refer guidance step 2 in AASB 15

- Can you allocate the funding to the performance obligations?
The Performance Obligations identified are CRITICAL because:

The transaction price is to be allocated to the performance obligation(s). **THIS IS OFTEN OVERLOOKED**

How you allocate across multiple performance obligations depends upon how you are measuring their completion!
The agreement may specify the transaction price per obligation

In the case of outputs, the transaction price might be allocated per output

In the case of an activity, may need to be allocated proportionately or evenly over the contract period.

Example: A enforceable grant to developing a training course with 10 modules

- Modules 1-3 represent 10% of the coursework
- Modules 4-8 represent 60% of the coursework
- Modules 9-10 represent 30% of the coursework

Expenses incurred across a contract may not necessarily reflect the performance obligations satisfied – not automatic matching of revenue with expense.
Licence revenue in the Public Sector
• In September 2018, the AASB issued AASB 2018-4 on accounting for licence revenue by not-for-profit public sector licensors.

• This amending standard brings licences issued by NFP public sector entities within the scope of AASB 15.

• Guidance on the accounting treatment now contained in Appendix G of AASB 15.
<table>
<thead>
<tr>
<th>Feature</th>
<th>Licence</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Is the arrangement discretionary rather than compulsory for the payer?</td>
<td>Discretionary (e.g., payer – the licensee has discretion over whether to perform an activity that requires permission and it is not compulsory if payment not made to retrospectively obtain the right, but subject to fines or other penalties)</td>
<td>Compulsory (e.g., non-discretionary payments for activities that are necessary for the entity to operate, for example earning revenue, and it is compulsory to pay the base amount in addition to penalty fees and interest)</td>
</tr>
<tr>
<td>(b) What is the primary purpose?</td>
<td>Non-financial purpose (e.g., equitable allocation of a public resource)</td>
<td>Generating income for the public sector entity (e.g., very high proceeds in relation to the costs incurred might be indicative of a tax element)</td>
</tr>
<tr>
<td>(c) Does the arrangement create direct rights to use or access an asset for the payer, or perform an activity, and, depending on the type of arrangement, direct obligations of the payee?</td>
<td>Creates direct rights for the payer (licensee), and could create direct obligations for the payee (licensor)</td>
<td>No specific rights for the payer or obligations for the payee</td>
</tr>
<tr>
<td>(d) Does the arrangement give the payer specific permission that must be obtained prior to performing an activity or using or accessing a resource of the payee that would otherwise be unlawful?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>(e) Does the arrangement transfer control of the payee’s underlying asset?</td>
<td>No</td>
<td>Not relevant</td>
</tr>
</tbody>
</table>

The guidance in **Appendix G distinguishes between licences and taxes** (refer paragraphs G3-G7).

This difference can be illustrated by the
- consequences of avoiding payment of the licence fee or tax;
- primary purpose
- rights and obligations
• IP Licenses
• Non IP Licences
  - right over a licensor’s **identified** assets;
    - might need to consider AASB 16
  - right over a licensor’s **non-identified** assets;
    - **distinct** from other promised goods and services?
      - Separate performance obligation
    - **indistinct** from other promised goods and services?
      - Bundled with other performance obligations

• The right to perform an activity – **THE MOST COMMON ONE!!!**
Licence Revenue in the Public Sector – AASB 15

• Licence revenue is effectively recognised by applying the same five-step model in AASB 15.

• Appendix G contains guidance on identifying performance obligations in relation to licence revenue.

• Most commonly, the sole performance obligation the agency will have is issuing the licence to the licensee. In this case revenue will be recognised when the licence is issued (i.e. upfront).

• Treasury expects that licence revenue will be recognised upfront coinciding with the issue of the licence in the majority of cases.
• An **exclusivity promise** is NOT a performance obligation, rather it is an attribute or feature of the licence.

*Example* – a promise to not issue a similar licence to another party and to ensure no other parties engage in the activities that the licensee has an exclusive right to perform.

• **Enforcement or policing activities** that are undertaken to benefit the general public rather than the licensee are NOT performance obligations as they do not transfer goods or services to the licensee.

*Example* – activities to ensure the licensee is not carrying out illegal activities or to ensure the licensee continues to meet eligibility requirements.
Similar to AASB 16, the amending standard allows exemptions for short-term licences and low value licences.

However, to ensure consistent revenue recognition and a cost effective implementation by agencies, Treasury intends to mandate that agencies will recognise revenue from all licences, including short-term licences and low-value licences, in line with AASB 15 principles.

In effect, Treasury intends that the practical expedients will not be applied by Queensland Government Agencies.
• Some licences fees received by agencies may be partially refundable (e.g. on a pro-rata basis) if the licensee decides to cancel their licence at any time.

• A refund obligation alone is insufficient to defer the revenue to be recognised on a straight line over the licence period.

• Agencies should instead apply AASB 15 paragraph 55 and estimate a portion of the licence fee that is expected to be refunded and recognise that portion as a refund liability.
Example –

- Based on historical data from the last 5 years, 2.5% of licence fees received each year end up being refunded.

- The agency levies $1,000,000 in licence fee in a given financial year. It would record $975,000 in revenue upfront and a refund liability of $25,000.

- The refund liability is debited when refunds are paid. The refund liability must also be reassessed and updated at the end of each reporting period, with any adjustment taken to revenue.
Transitional Considerations and Grant Expenses
Transitional Considerations for AASB 1058

• Treasury **INTENDS TO MANDATE** the partial retrospective approach in paragraph C3(b) of AASB 1058.

• Under this transition approach, agencies will **not need to restate comparative figures** in their 2019-20 financial statements.

• Recognise the cumulative effect of applying this standard as an adjustment to opening accumulated surplus at 1 July 2019.

• Additional disclosures in paragraph C7 are required when using this approach.
Treasury INTENDS TO PROHIBIT the election in paragraph C6 of applying the standard retrospectively only to contracts that are not completed contracts at 1 July 2019.

A completed contract is one where the agency has already recognised all of the income in accordance with AASB 1004 prior to 1 July 2019.

Treasury’s concern – agencies may not be able to restate unearned revenue previously recognised under AASB 1004.
• This means agencies will be required to assess:

  ➢ any operating grants recognised as revenue/income prior to 1 July 2019 where sufficiently sufficient performance obligations are still to be completed under an enforceable contract;

  ➢ capital grants recognised as revenue/income prior to 1 July 2019 for which construction of the asset is not yet completed and recognise a liability reflecting the ‘unspent’ amount on transition.
• Treasury **INTENDS TO MANDATE** the practical expedient in paragraph C8.

• Allows agencies to **ignore** remeasuring assets at fair value on transition to AASB 1058 that were acquired for significantly less than fair value *prior to 1 July 2019* (and originally measured at cost).

• Shouldn’t be an issue given QT’s NCAP policies. But can ignore plant and equipment that fall into this category.
Grant Expenses – Does AASB 1058 apply?

- AASB 1058 and AASB 15 do not apply to grant expenses.
- No specific AASB Standard covers accounting for grant expense as yet...but in the future???
- Doesn’t mean we can ignore conceptual framework and guidance from other Standards.
- A prepayment will realistically only arise where the entity providing the consideration directly controls the benefits embodied in the asset and is yet to receive those benefits.
Grant Expenses – Does AASB 1058 apply?

- Prepayments will typically only represent genuine procurement transactions for the future delivery of goods or services not yet received by the entity (i.e. transactions that are ‘reciprocal’).

- Under AASB 15, the economic benefits embodied within a grant may be provided to third parties on the grantor’s behalf and the revenue will still qualify for deferral.

- BUT as the grantor itself does not directly control the economic benefits embodied in the right to receive goods or services, the definition of an asset will not be met.
Grant Expenses – Does AASB 1058 apply?

• Treasury’s proposed accounting policy (from the grantor’s perspective) will be that for all grants where the benefit is provided to third parties, **the grantor shall recognise grant expense upfront when the grant is paid** (or when the grantee becomes entitled to the grant, if earlier).

• In practice, we do not anticipate grant expenditure will qualify for capitalisation as a prepaid asset and expect no material change from the current accounting treatment for grant expenditure.

• The grantor may recognise expenses earlier than when the grantee recognises revenue.
Got an accounting policy question or require accounting advice?

Treasury can help

Email: fmhelpdesk@treasury.qld.gov.au