

A photograph of a modern architectural interior, likely a museum or corporate headquarters. The space features curved balconies with teal-colored railings and a central staircase with a glass railing. The lighting is bright and even, highlighting the clean lines and materials of the architecture.

# BUSINESS PROBLEMS CREATED BY THE THREE NEW ACCOUNTING STANDARDS

May 2020

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**2020 IS GOING TO BE A BIG YEAR FOR  
NFP ENTITIES!**



# INTRODUCTION

# OUTLINE OF THIS SESSION

- ▶ 1 January 2019 - The Clock is Ticking Down!
- ▶ AASB 15 *Revenue from Contracts with Customers*
- ▶ AASB 1058 *Income of Not-for-Profit Entities*
- ▶ AASB 16 *Leases*, especially *Peppercorn Leases*
- ▶ Questions Directors Should Ask
- ▶ Next Steps
- ▶ Do you need assistance?



**1 JANUARY 2019 - THE CLOCK IS TICKING DOWN!**

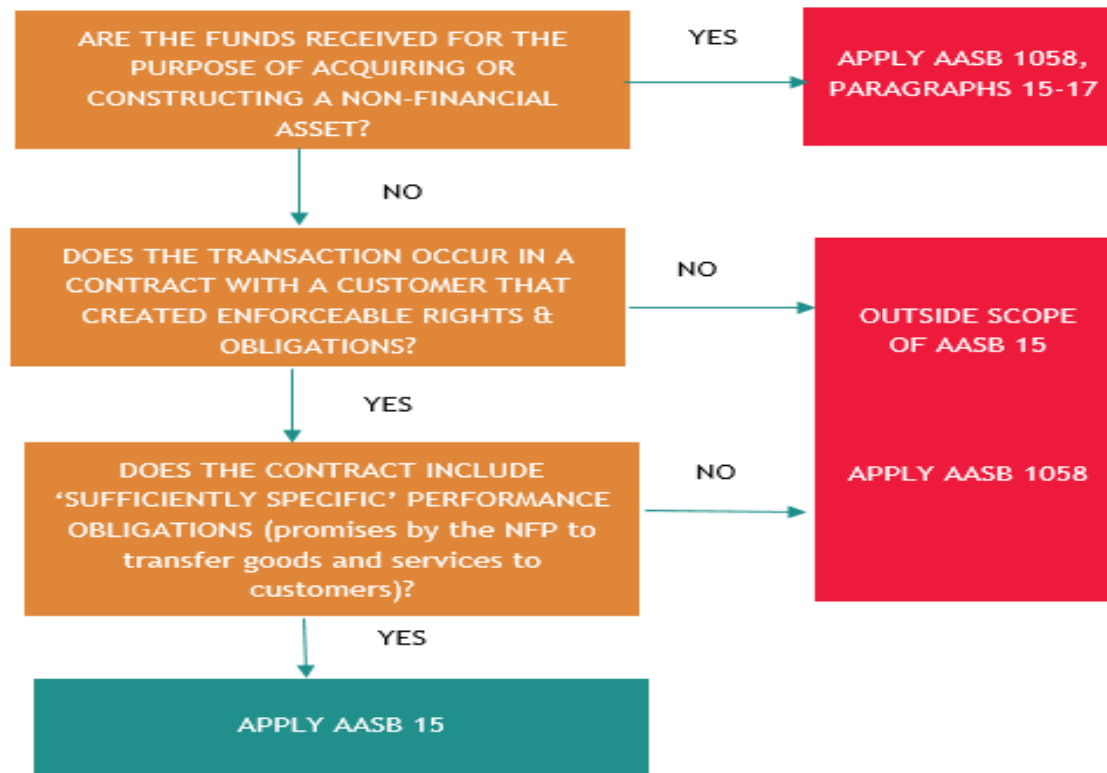
# NOT-FOR-PROFIT ENTITIES

Already  
implemented

Accounting Standard	Effective Date - Years Beginning on or after ...	31 December Year-ends	30 June Year- ends
AASB 9 <i>Financial Instruments</i>	1 January 2018	31 December 2018	30 June 2019
AASB 15 <i>Revenue from Contracts with Customers</i>	1 January 2019	31 December 2019	30 June 2020
AASB 16 <i>Leases</i> , including peppercorn leases	1 January 2019	31 December 2019	30 June 2020
AASB 1058 <i>Income of Not-for-Profit Entities</i>	1 January 2019	31 December 2019	30 June 2020

# *AASB 15 REVENUE FROM CONTRACTS WITH CUSTOMERS*

# WHEN DOES AASB 15 APPLY TO NFP ENTITIES?



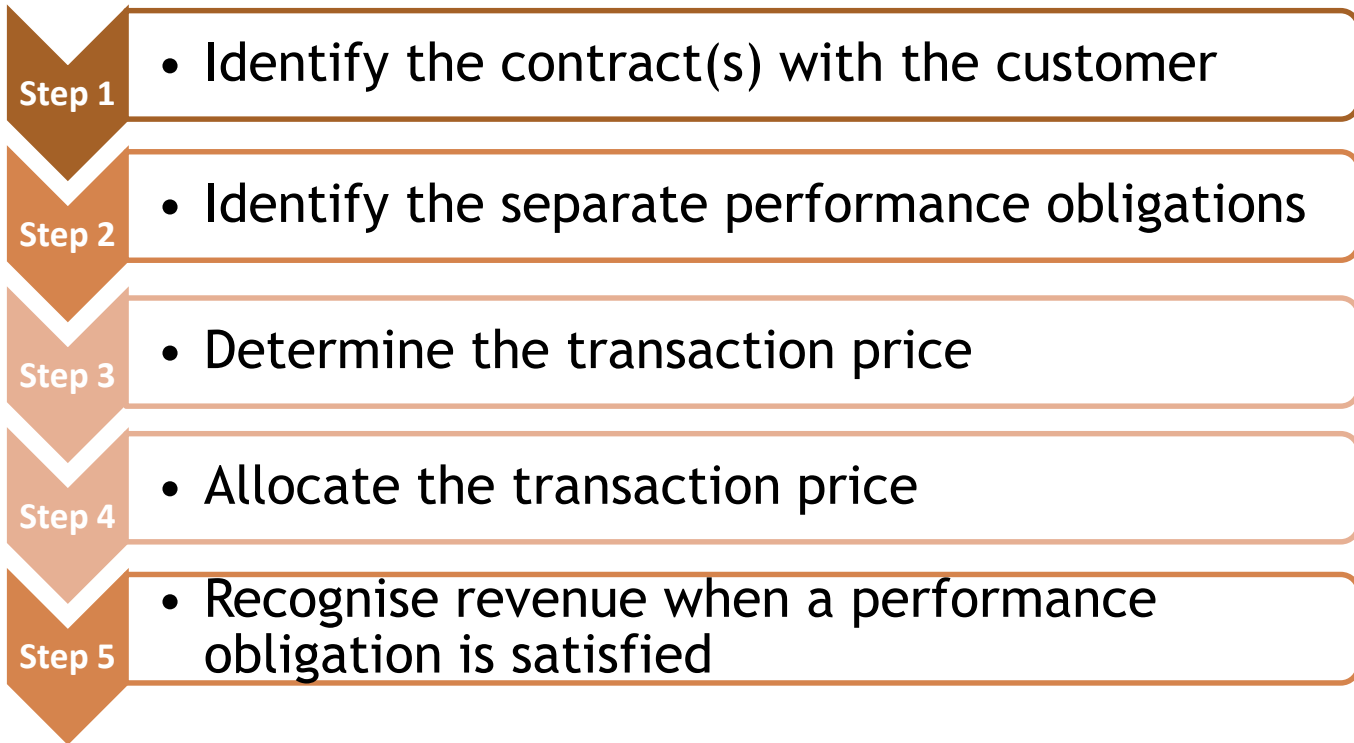


# CORE PRINCIPLE

Recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

- A customer is a party that has **contracted** with an entity to obtain goods or services that are an output of the entity's **ordinary activities** in exchange for consideration

# FIVE STEPS TO APPLY THE CORE PRINCIPLE



## EXAMPLE 1 - ENDOWMENT MADE TO A UNIVERSITY

- ▶ On 30 June 2018, an alumnus transferred \$2 million cash to University A as an endowment
- ▶ Under the terms of the endowment:
  - The \$2 million cash can be invested at the university's discretion
  - University A is required to provide the annual scholarship for one student's accommodation for a defined period of 30 years. (Assume the expected cost of the annual scholarship over the next 30 years is \$1,850,000)
  - If the university breaches the terms of the endowment, the university is required to return the real value of the principal to the alumnus
- ▶ The entity's reporting date is 30 June

## EXAMPLE 1 - ENDOWMENT MADE TO A UNIVERSITY

### ► Journal entry at 30 June 2018

- |                         |             |             |
|-------------------------|-------------|-------------|
| • Dr Cash               | \$2,000,000 |             |
| • Cr Contract liability |             | \$1,850,000 |
| • Cr Income             |             | \$150,000   |

### ► Journal entry at 30 June 2019

- |                         |          |          |
|-------------------------|----------|----------|
| • Dr Contract liability | \$61,667 |          |
| • Cr Income             |          | \$61,667 |

(\$1,850,000 ÷ 30 years)

## EXAMPLE 2 - MULTI-YEAR CASH GRANT

- ▶ The Local Government enters into an agreement with the State Government in the form of a Memorandum of Understanding (MoU) to receive a multi-year cash grant of \$90,000 from the State Government, which is received in full on 24 June 2018
- ▶ The grant is to fund education programs over three years commencing 1 July 2018, with the objective of increasing the literacy of students of a specific rural area
- ▶ The MOU outlines the agreed activities of education programs that are tailored to the literacy needs of the students. The Local Government is able to identify when its specific performance obligations are satisfied and expects to fulfil its promise to provide the agreed activities
- ▶ The State Government can enforce the repayment of the grant if the specified activities are not undertaken by requiring direct repayment or otherwise deducting unspent monies from future funding
- ▶ The entity's reporting date is 30 June

## EXAMPLE 2 - MULTI-YEAR CASH GRANT

► Journal entry at 24 June 2018

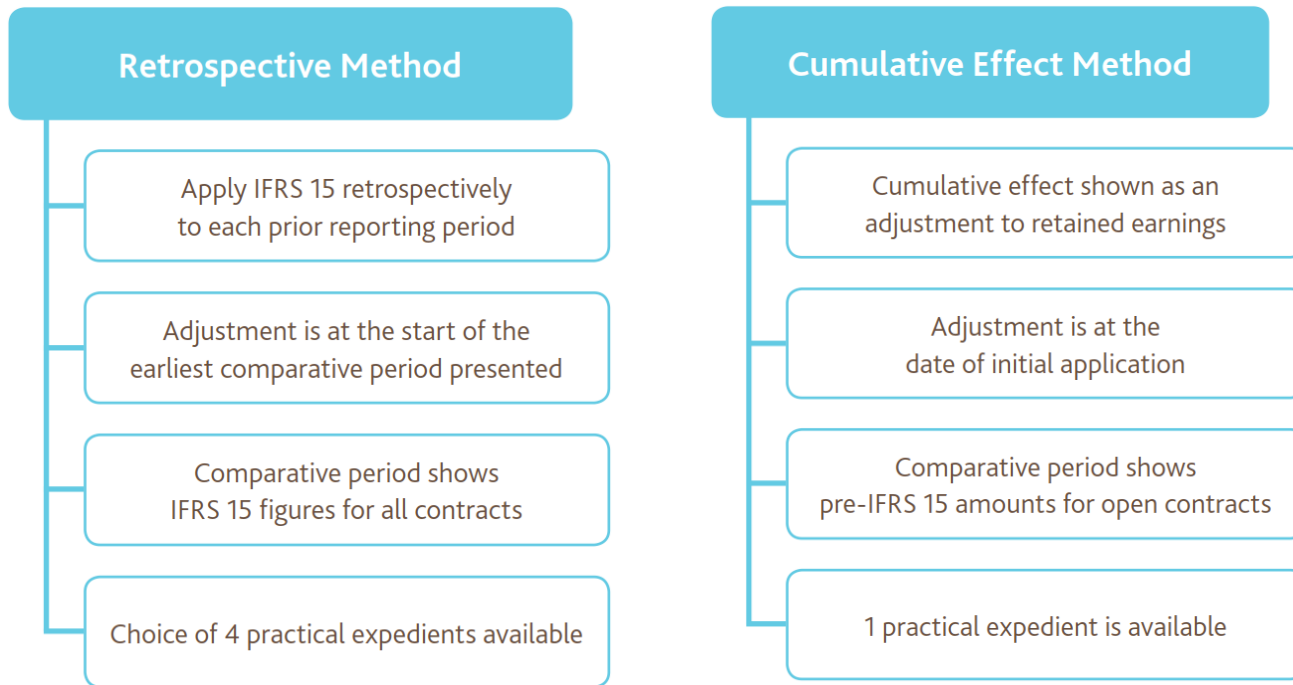
- Dr Cash \$90,000
- Cr Contract liability \$90,000

► Journal entry at 30 June 2019

- Dr Contract liability \$30,000
  - Cr Income \$30,000
- (\$90,000 ÷ 3 years)

# APPROACH TO TRANSITIONING TO AASB 15

## Options available



## EXAMPLE 3 - TRANSITION TO AASB 15

### Difference between 2 transition methods

	Financial year ending 30 June 2020	Financial year ending 30 June 2019	Financial year ending 30 June 2018
Income recognised: Old AASB 118 or AASB 1004	\$0	\$0	\$90,000
Income recognised: New AASB 15	\$30,000	\$30,000	\$0
Full Retrospective Method			
<ul style="list-style-type: none"><li>Income recognised</li><li>Opening retained earnings</li></ul>	\$30,000	\$30,000 (\$90,000)	N.A.
Modified/Cumulative Retrospective Method			
<ul style="list-style-type: none"><li>Income recognised</li><li>Opening retained earnings</li></ul>	\$30,000 (\$60,000)	\$0	N.A.



## EXAMPLE 3 - TRANSITION TO AASB 15

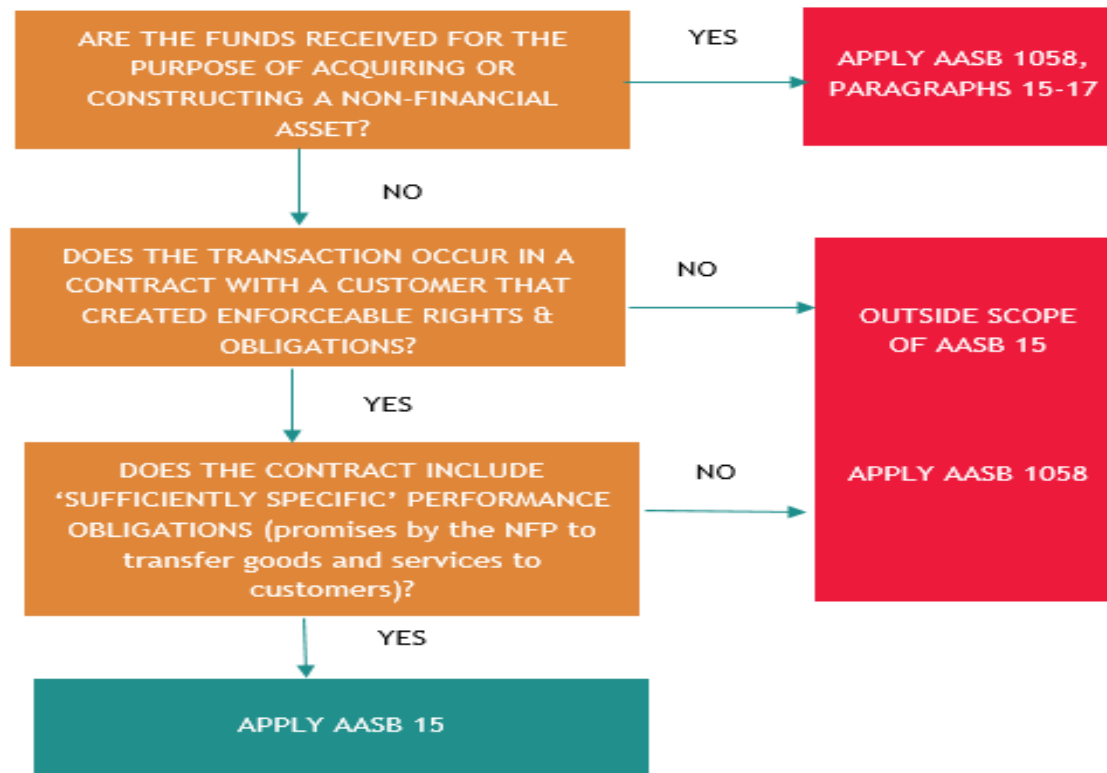
### ► Journal entry at 1 July 2019

- Dr Retained Earnings - Opening Balance \$60,000
- Cr Income \$30,000
- Cr Contract liability \$30,000

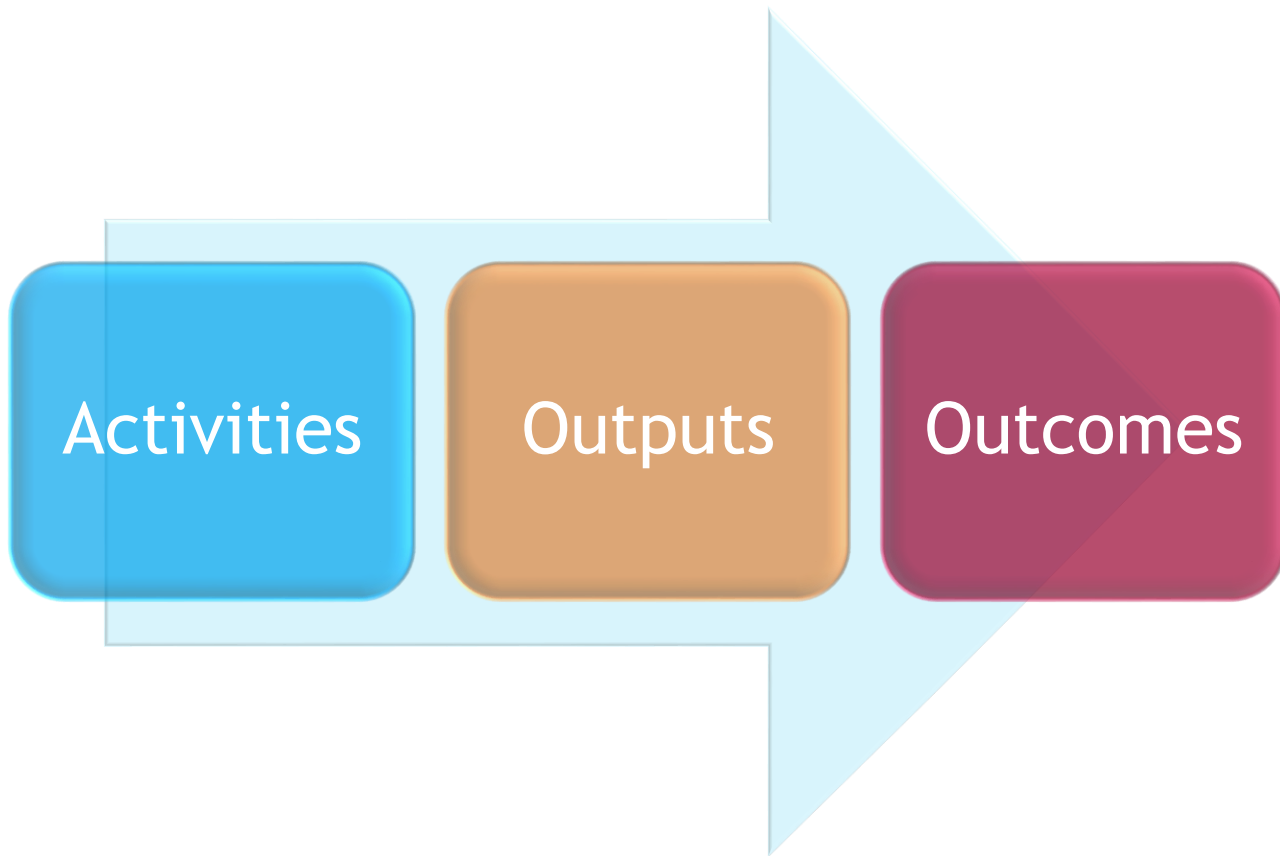


# **AASB 1058 *INCOME OF NOT-FOR-PROFIT ENTITIES***

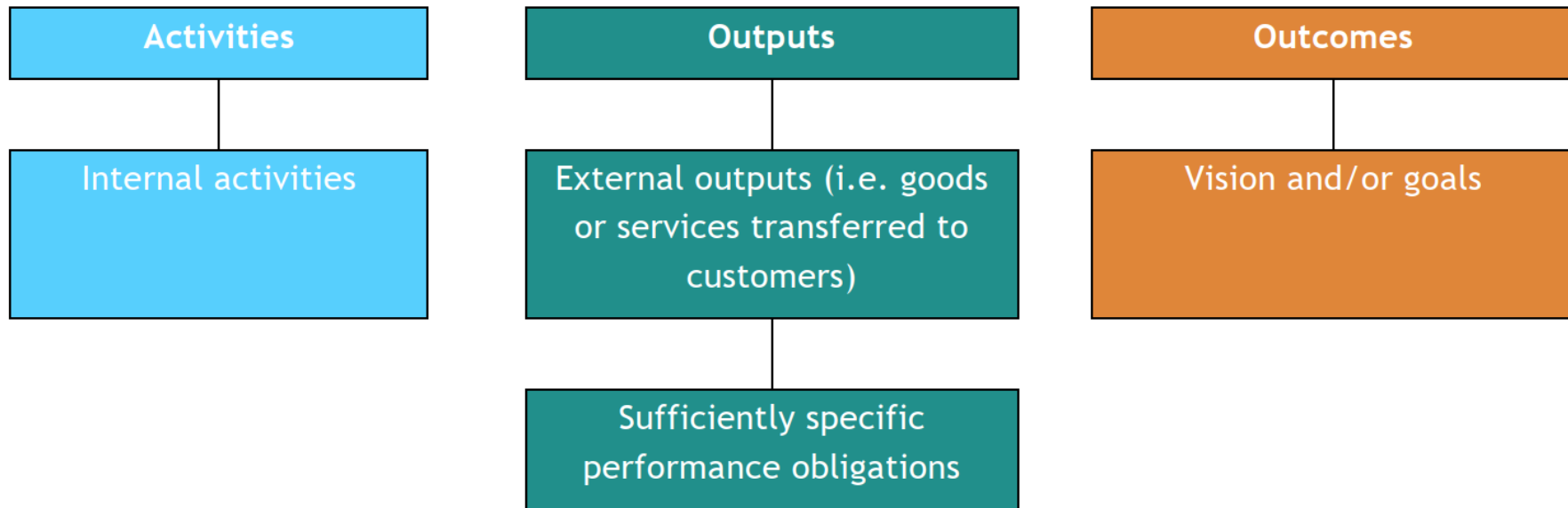
# WHEN DOES AASB 15 APPLY TO NFP ENTITIES?



# SUFFICIENTLY SPECIFIC PERFORMANCE OBLIGATIONS



# SUFFICIENTLY SPECIFIC PERFORMANCE OBLIGATIONS



## EXAMPLE 4 - CASH GRANT FOR THE CONSTRUCTION OF A RECOGNISABLE ASSET & INCOME RECOGNISED AT A POINT IN TIME

- ▶ The State Government makes a cash grant of \$100,000 to Hospital X to acquire 16 intensive care hospital beds that are to be controlled by the entity and used in its operations
- ▶ Six beds are acquired by the hospital in its first purchase, and the remaining ten beds in a second purchase
- ▶ Hospital X determines:
  - The \$100,000 grant is an asset Hospital X acquired for consideration that is significantly less than the fair value of the grant to further the objectives of the hospital
  - Accordingly, the grant is within the scope of AASB 1058 and it controls a financial asset (\$100,000) within the scope of AASB 9

## EXAMPLE 4 - CASH GRANT FOR THE CONSTRUCTION OF A RECOGNISABLE ASSET & INCOME RECOGNISED AT A POINT IN TIME

- ▶ In accordance with paragraph 16 of AASB 1058, Hospital X recognises the grant initially as a liability at the point in time when it obtains control of the funds. Hospital X recognises income as it acquires and controls the hospital beds

## EXAMPLE 4 - CASH GRANT FOR THE CONSTRUCTION OF A RECOGNISABLE ASSET & INCOME RECOGNISED AT A POINT IN TIME

► The journal entries for the accounting treatment are:

- Initial recognition
- Dr Cash 100,000
- Cr Obligation 100,000
- First purchase
- Dr Obligation 37,500
- Cr Income 37,500
- Dr Equipment - ICU 37,500
- Cr Cash 37,500



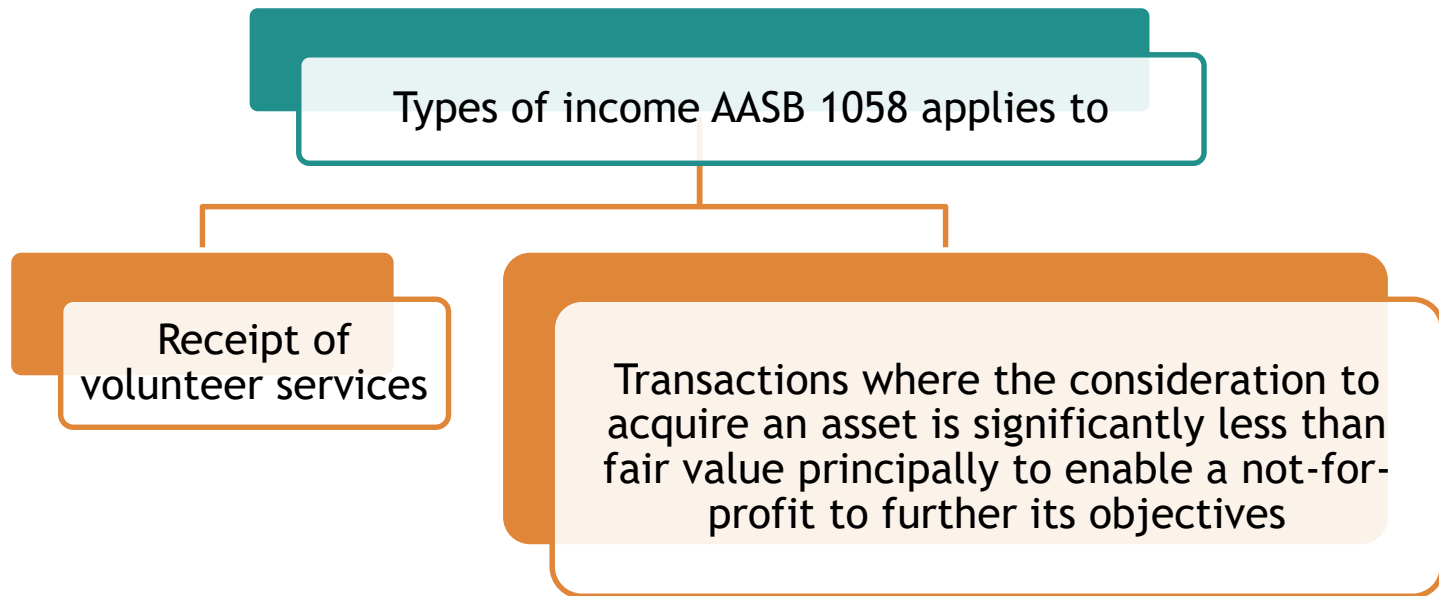
## EXAMPLE 4 - CASH GRANT FOR THE CONSTRUCTION OF A RECOGNISABLE ASSET & INCOME RECOGNISED AT A POINT IN TIME

► The journal entries for the accounting treatment are:

- Second purchase
- Dr Obligation 62,500
- Cr Income 62,500
- Dr Equipment - ICU 62,500
- Cr Cash 62,500

# AASB 1058 *INCOME OF NOT-FOR-PROFIT ENTITIES*

## Scope of AASB 1058



# TRANSACTIONS OTHER THAN VOLUNTEER SERVICES

## Recognition and measurement principle

Asset (A)	'Credit' (B)	Excess of (A) over (B)
Where applicable, account for in accordance with other Australian Accounting Standards	Where applicable, account for in accordance with other Australian Accounting Standards	Excess recognised <u>immediately</u> in profit or loss
AASB 1058, paragraph 8	AASB 1058, paragraph 9	AASB 1058, paragraph 10

## EXAMPLE 5 - MULTI-YEAR CASH GRANT

- ▶ The Local Government enters into an agreement with the State Government in the form of a Memorandum of Understanding (MoU) to receive a multi-year cash grant of \$90,000 from the State Government, which is received in full on 24 June 2018
- ▶ The grant is to fund education programs over three years commencing 1 July 2018, with the objective of increasing the literacy of students of a specific rural area
- ▶ The MoU does not specify the activities the grant must be used for, other than an education program to increase literacy in a particular area
- ▶ The State Government can enforce the repayment of the grant if the entity does not apply the funds to relevant education programs
- ▶ The entity's reporting date is 30 June

## EXAMPLE 5 - MULTI-YEAR CASH GRANT

► Journal entry at 24 June 2018

- Dr Cash \$90,000
- Cr Income \$90,000



# IFRS 16 *LEASES*

# THE BIG CHANGE FOR LESSEES

The end of the road for operating leases!





## EXAMPLE 6

### Background information

Entity A entered into a 3 year lease of an administration building with the following lease payments, payable at the beginning of each month:

- \$5,000 per month for the first 12 months;
- \$6,000 per month for the next 12 months; and
- \$7,000 per month for the last 12 months

Entity A's incremental borrowing rate is 10% per year annum



## EXAMPLE 6

### Accounting treatment in terms of the current AASB 117

Lease payments in year 1 ( $\$5,000 \times 12$ months)	\$60,000
Lease payments in year 2 ( $\$6,000 \times 12$ months)	\$72,000
Lease payments in year 3 ( $\$7,000 \times 12$ months)	\$84,000
<b>Total lease payments over the lease term</b>	<b>\$216,000</b>
Even operating lease expense for years 1 to 3 ( $\$216,000 / 3$ years)	\$72,000

## EXAMPLE 6

### Accounting treatment in terms of the new AASB 16

Opening Balance	Cash Lease Payments	Interest Expense	Principal Repaid	Closing Balance
0	-	-	-	185,426
1	60,000	14,896	45,104	140,321
2	72,000	11,300	60,700	79,622
3	84,000	4,378	79,622	-
Total	216,000	30,574	185,426	N.A.

## EXAMPLE 6

### Impact on the statement of profit or loss and other comprehensive Income

	Year 1		Year 2		Year 3	
	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16
Operating lease expense	72,000		72,000		72,000	
Interest expense		14,896		11,300		4,378
Amortisation expense		61,809		61,809		61,809
Total expense	72,000	76,705	72,000	73,109	72,000	66,187

## EXAMPLE 6

### Impact on the statement of financial position

	Year 1		Year 2		Year 3	
	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16
<b>Non-current assets</b>						
Right-of-use asset	0	\$123,617	0	\$61,808	0	0
<b>Current liabilities</b>						
Lease liability	0	(\$60,700)	0	(\$79,622)	0	0
<b>Non-current liabilities</b>						
Lease liability		(\$79,622)		0	0	0
<b>Net current assets or liabilities</b>		(\$60,700)		(\$79,622)		
<b>Net assets or liabilities</b>	0	(\$16,704)	0	(\$17.814)	0	0

## EXAMPLE 6

### Impact on the statement of cash flows

Statement of Cash Flows	Year 1		Year 2		Year 3	
	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16	Current AASB 117	New AASB 16
Operating cash flows	(\$60,000)		(\$72,000)		(\$84,000)	
Financing or operating cash flows - Interest expense		(\$14,896)		(\$11,300)		(\$4,378)
Financing cash flows - Repayment of principle amount		(\$45,104)		(\$60,700)		(\$79,622)
<b>Total</b>	<b>(\$60,000)</b>	<b>(\$60,000)</b>	<b>(\$72,000)</b>	<b>(\$72,000)</b>	<b>(\$84,000)</b>	<b>(\$84,000)</b>

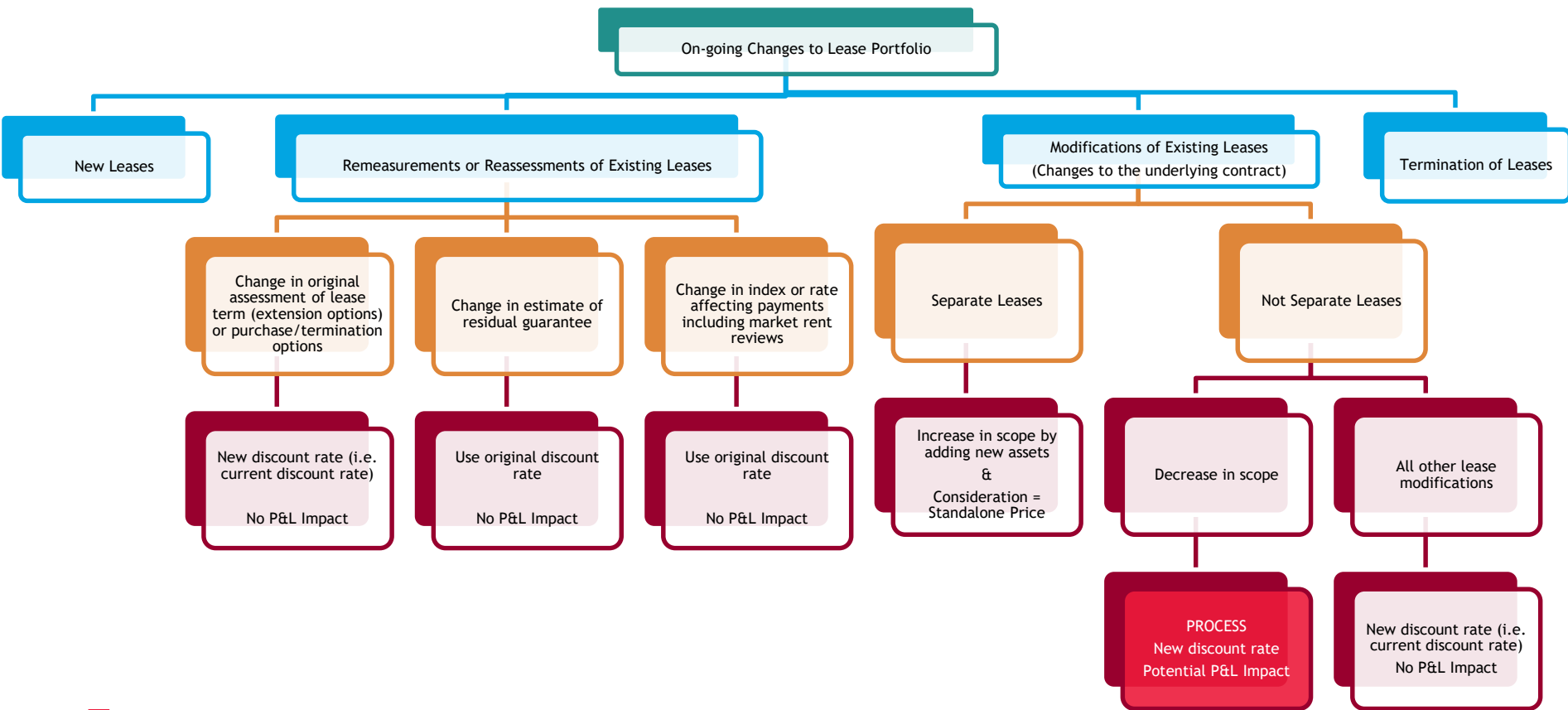


# POTENTIAL IMPACT

Impact on financial statements, key ratios and other KPIs

- ▶ Profit volatility
- ▶ Net current assets
- ▶ EBITDA
- ▶ Bank covenants
- ▶ Declaration of dividends
- ▶ Interest rate cover
- ▶ Debt/equity ratio

# ON-GOING CHANGES TO LEASE PORTFOLIO



# PEPPERCORN LEASES

## Amendment to new AASB 16 *Leases*

- Where the lessee is a NFP entity and the lease has significantly below-market terms and conditions principally to enable the entity to further its objectives, the NFP entity **shall**:
  - Measure the right-of-use asset at fair value;
  - Measure the lease liability at the present value of the lease payments that are not paid at that date; and
  - Recognise any related items in accordance with AASB 1058 (potentially income?)
- **However, also consider the latest developments at the AASB re peppercorn leases**



## EXAMPLE 7 - LEASE

- School A enters a 30 year lease with a lessor for the use of a building
- The lease contract specifies lease payments of \$100 per annum
- At the inception of the lease, the entity assesses the terms and conditions of the lease, including restrictions, and determines the fair value of the right to use the facility for 30 years is \$360,000
- The leased premises must be used to provide education services, or else School A will no longer be able to use the facility
- There are no other conditions specified in the lease contract
- Assume the NPV of the future lease payments discounted at School A's incremental borrowing rate of 5% per annum is \$1,537

## EXAMPLE 7 - LEASE

- The journal entry on initial recognition is:

- Dr Right-of-use asset	\$360,000	
- Cr Lease liability		\$1,537
- Cr Income		\$358,463
- However, also consider the latest developments at the AASB re peppercorn leases

## LATEST DEVELOPMENT - AASB ISSUED AASB 2018-8 IN DECEMBER 2018

- However, the AASB has decided to provide a temporary option for not-for-profit entities to **not** measure a class or classes of such right-of-use assets at initial recognition at fair value, since further guidance is expected to be developed to assist not-for-profit entities in measuring right-of-use assets at fair value
- The temporary option would also avoid requiring not-for-profit private sector entities at the lower level of the reporting thresholds to apply the fair value initial measurement requirements of AASB 16 when they might not be required to apply these requirements in the future as a result of recommendations of the ACNC Legislative Review

# DEFERRAL OF REQUIREMENT TO FAIR VALUE PEPPERCORN LEASES

## How long will the temporary deferral option remain?

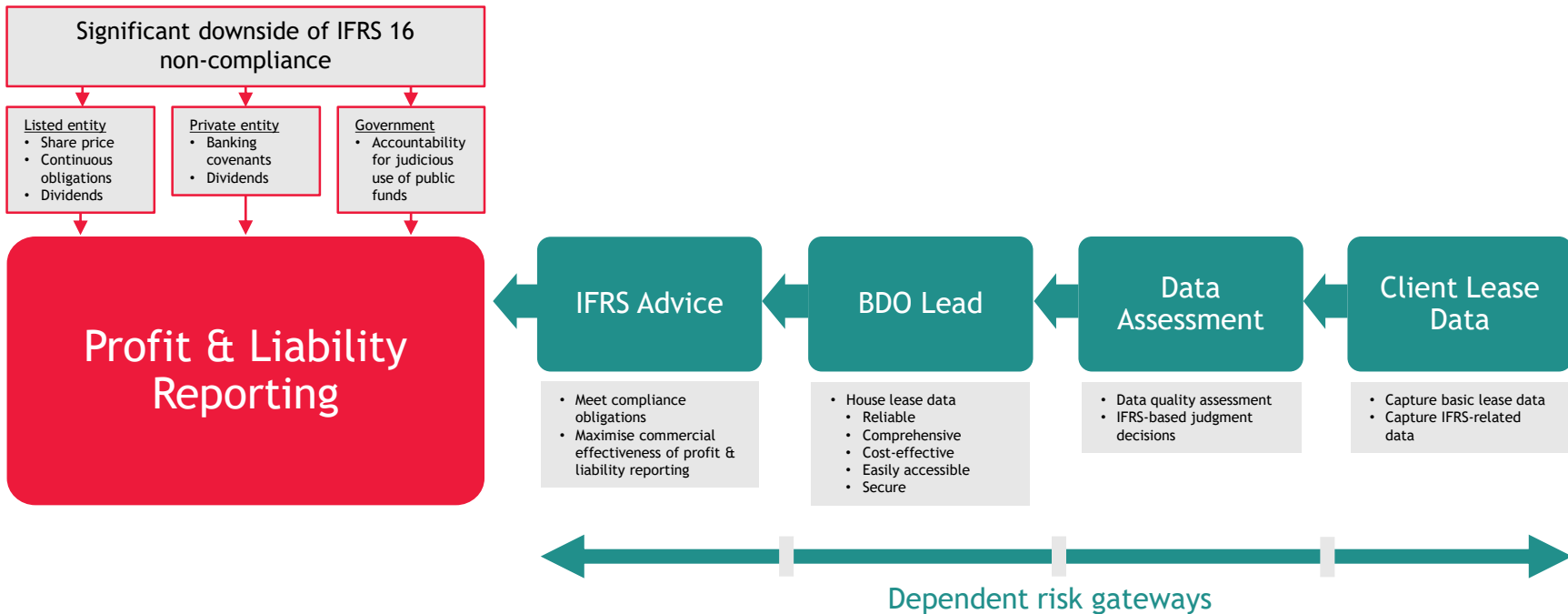
- Deferral option expected to remain in place until guidance has been developed for fair-valuing right-of-use assets (i.e. with restrictions) and the financial reporting requirements for private sector NFPs have been finalised

## How will entities apply this deferral option in their 2019 financial statements?

- Measure the ROU asset at the present value of payments (usually an insignificant amount)
- Additional disclosure required to ensure users understand effects of the peppercorn lease on the financial performance, financial position and cash flows of the entity

## Public Sector Entities & NFP Entities - Maintain Public Support

IFRS 16 will create winners and losers for organisations with multiple leases, depending on how effectively they control the risk at each point in the lease management lifecycle.





AFR, 5 SEPTEMBER 2018

<https://www.afr.com/business/retail/myer-woolworths-hardest-hit-by-new-lease-accounting-standard-20180905-h14yqo>

Myer, Woolworths hardest hit by new lease accounting standard



AFR, 9 JULY 2017

<https://www.afr.com/business/retail/wesfarmers-woolworths-among-retailers-bracing-for-new-lease-accounting-rules-20170706-gx69ij>

Wesfarmers, Woolworths liabilities to double under lease accounting change



**AFR, 20 MARCH 2019**

<https://www.afr.com/markets/equity-markets/100b-of-lease-liabilities-headed-for-balance-sheets-20190320-p515ol>

\$100b of lease liabilities headed for balance sheets





## BDO'S SERVICE OFFERING RE IFRS 16

1. BDO Lead - IFRS 16 & Lease Management Solution
2. BDO Lease Management Services
3. Calculate the Transition Adjustment
4. IFRS 16 Implementation Advice



# QUESTIONS DIRECTORS SHOULD ASK

# QUESTIONS DIRECTORS SHOULD ASK IN RELATION TO THE NEW ACCOUNTING STANDARDS

- ▶ <https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-16-issue-10/questions-directors-should-ask-for-the-new-aasb-standards>

# OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ How do these accounting standards impact the profit of the organisation in year of implementation and thereafter?
- ▶ How do these accounting standards impact the balance sheet position (assets, liabilities & equity) of the organisation in the year of implementation and thereafter?
- ▶ How have we updated and incorporated these new accounting standards into our budgets and forecasts?
- ▶ Would the organisation be able to continue to meet their current bank covenants?

# OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ Should the organisation renegotiate their bank covenants to minimise the potential impact of the new accounting standards on their current bank covenants?
- ▶ What is the impact of the new accounting standards on current remuneration structures and incentives to key management personnel and other employees?
- ▶ Does the organisation need to adjust performance hurdles and KPIs of key management personnel and other employees, to reflect the impact of the new accounting standards?
- ▶ How are we going to communicate the immediate and future impact of the new accounting standards users of our financial statements?

# OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ Has the organisation performed and documented an impact and/or risk assessment of the implementation of the new accounting standards?
- ▶ Does the organisation have documented position papers to support and justify the appropriate accounting treatment of existing transactions under the new accounting standards?
- ▶ Has the organisation updated their accounting policy manual to reflect the requirements of the new accounting standards?
- ▶ Has the organisation obtained independent accounting advice in relation to the implementation of the new accounting standards?

# OVERALL QUESTIONS DIRECTORS SHOULD ASK

- ▶ Have the auditors of the organisation been involved in the discussions and impact assessment of the new accounting standards on the organisation?
- ▶ What research has been done on the potential impact of the new accounting standards on the organisation's industry?
- ▶ Has the organisation considered their technology needs and required changes to their existing systems and processes to deal with the new accounting standards?
- ▶ How can the directors access further information on the requirements and potential implications of the new accounting standards?

# QUESTIONS DIRECTORS SHOULD ASK RE IFRS 16

- ▶ Has the organisation decided on an appropriate transitional approach?
- ▶ What process did the organisation follow to decide on the appropriate transitional approach in relation to AASB 16?
- ▶ What is the impact of each of the three possible transitional approaches on the organisations:
  - Retained earnings at the date of initial application
  - Lease liabilities and right-of-use assets at the date of initial application
  - Profit before tax (i.e. depreciation and interest expenses)



# QUESTIONS DIRECTORS SHOULD ASK RE IFRS 16

- ▶ Does the organisation have a register of all leases?
- ▶ Does the organisation have a copy of all lease agreements?
- ▶ What process did the organisation follow to identify all leases, including embedded leases?
- ▶ How did the organisation decide whether it is reasonably certain to exercise lease extension options, termination options and purchase options included in lease agreements?
- ▶ Does the organisation have a technology solution to manage leases on an ongoing basis, i.e. after the date of initial application?



# NEXT STEPS



## NEXT STEPS

### ▶ AASB 15 & AASB 1058

- Do your clients receive government grants?
- What other funding do your clients receive?
- Schools - Application fees & enrolment fees?

### ▶ AASB 16 & Peppercorn Leases

- Do you have copies of all your operating & finance leases?
- Do you have all the data to perform the AASB 16 calculations?
- Do you have a technology solution?

## NEXT STEPS

- ▶ Have you educated yourself and your team re the technical requirements of these 3 new accounting standards?
- ▶ Have you done a risk assessment re each of these 3 accounting standards?
- ▶ Have you designed an appropriate response to the completed risk assessment re each of the 3 accounting standards?
- ▶ Have you designed a **project plan** re the implementation of these 3 accounting standards?
- ▶ Have you decided on an appropriate **transitional approach** re each of the 3 accounting standards?
- ▶ Have you changed and improved your systems and processes to deal with the 3 new accounting standards?



**DO YOU NEED ASSISTANCE?**

# FREE RESOURCES

## ▶ Monthly Webinars

- <https://www.bdo.com.au/en-au/insights/audit-assurance/webinars/2019-bdo-financial-reporting-and-accounting-standards-webinar-series>

## ▶ Interactive E-learning

- <https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/accounting-standards-training>

## ▶ Monthly Accounting News

- <https://www.bdo.com.au/en-au/accounting-news/accounting-news-december-2019>

## ▶ IFRS Publications

- <https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/ifrs-publications>

## AASB 16 - FP & NFP



# BDO LEASE MANAGEMENT SERVICES (OUTSOURCING)

- ▶ <https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/ifrs-16/lease-management-services>
- ▶ Can be provided to non-PIE audit clients of BDO



# BDO LEAD SAAS

- ▶ <https://www.bdo.com.au/en-au/services/audit-assurance/ifrs-advisory-services/ifrs-16/lease-management-ifrs-16-tool>
- ▶ Cannot be provided to audit clients of BDO

# AASB 16 MASTERCLASSES

- ▶ <https://www.bdo.com.au/en-au/accounting-news/accounting-news-october-2019/aasb-16-masterclasses>
- ▶ More AASB 16 Masterclasses to be scheduled for May and June 2020

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# QUESTIONS



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