

A photograph of a lighthouse with a black base, a red middle section, and a white top section, situated on a rocky pier. The sky is blue with scattered white clouds, and the sea is visible in the background.

Viewpoint

Not-for-profit

All not-for-profit entities preparing financial reports will be required to use the new AIFRS.

Australian International Financial Reporting Standards and Not-for-profit entities

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Challenge area

All not-for-profit entities preparing financial reports will be required to use the new Australian equivalents to International Financial Reporting Standards (AIFRS). For many entities preparing their first set of AIFRS accounts this will involve a considerable time commitment and the risk of delays in preparing the accounts, additional costs in preparation and even the possibility of qualified audit reports.

This thought leadership piece points out the key areas not-for-profits needs to be aware of under the new reporting standards.



A NFP can be either a single entity or a group.

New perspectives

Am I a Not-for-Profit Entity (NFP)?

A not-for-profit entity is defined in the accounting standards as “an entity whose principal objective is not the generation of profit”. A NFP can be either a single entity or a group.

Transition

All not-for-profit entities transitioned to AIFRS 2 years ago and must restate financial reports from their transition date. To start the process, NFPs must convert two previously audited balance sheets and one income statement to AIFRS.

For entities with a 30 June year-end, the actual date of transition to AIFRS was 1 July 2004. The 30 June 2006 financial report must therefore include restated comparatives for 30 June 2005. This requires redetermination of the following:

Potential Major Impact Areas

The following are potential areas of major impact for entities preparing their first set of AIFRS accounts:

- Accounting for investments
- Debt v. equity
- Current v. non-current liabilities
- Measurement of financial assets and liabilities
- Accounting for investment properties
- New disclosure requirements
- Defined benefit superannuation plans
- Impairment testing.

Accounting for Investments

For entities with investment portfolios, market valuations must be obtained at 30 June 2004, 2005 and 2006. These investments are likely to be classified as Available-for-Sale Securities (AFS) with any upward revaluations taken to an AFS reserve (not the income statement).

This may significantly strengthen the balance sheets of entities that have previously recorded investments at cost, but may reduce the earnings of entities that have previously recorded increments in the market value of investments in income.



Financial instruments are to be classified as debt if the issuer has a contractual obligation to pay out cash to the holder of the instrument.

AIFRS also introduces the concept of “recycling” whereby “realised profits” (representing sale proceeds vs. historic cost) are recognised in the income statement as profit when they are actually sold. This will involve not-for-profit entities having to maintain detailed records of the original cost of their investments and releasing elements of the AFS reserve each time an investment is sold.

Action Points

- Obtain market value of investments as at 30 June 2004, 2005 and 2006.
- Establish an AFS reserve.
- For investments sold since 1 July 2004, apply “recycling”.

Debt vs. equity

Financial instruments are to be classified as debt if the issuer has a contractual obligation to pay out cash to the holder of the instrument.

For Co-operatives, members’ units will be repaid when the member ceases to be a member. These units will now be classified as debt rather than equity and the ‘equity’ portion restated as a liability on transition. This can lead to the unusual situation of entities having no equity and/or negative reserves.

Action Points

- Analyse all equity items to determine whether any should be reclassified as debt.

Current v. non-current liabilities

If an entity has not obtained the legal right to defer a payment on a liability for more than 12 months, the liability must be classified as current.

This has major impacts for liabilities such as deposit bonds in retirement villages that are usually legally repayable within a specific number of days of repayment being demanded. The fact that there are detailed statistics to support the assumption that the likelihood of requests for repayment is remote is irrelevant to the classification of these bonds.



Where long-term debt becomes due within 12 months it must be presented as a current liability..

The same principle applies to the classification of long service leave provisions. If the employee is legally entitled to the leave, this becomes a current liability, even though the employee is unlikely to take their leave in the next 12 months.

Where long-term debt becomes due within 12 months it must be presented as a current liability, even if it is management's intention to roll-over the loan. Such loans can only be presented as a non-current liability where the entity has obtained written confirmation from the bank, prior to year-end, to defer repayment on the loan. For example, if at 30 June the entity is still negotiating with their bankers to rollover the loan and actually signs the contract on 1 July (after yearend), the debt would be required to be presented as a current liability because at year-end the entity did not have a legal right to defer repayment.

Action Points

- Check repayment terms associated with noncurrent liabilities.
- For all borrowings in the process of being rolled over, ensure that the entity has received confirmation to defer repayment from the bank before year-end.

Measurement of financial assets and liabilities

The new Australian accounting standards dealing with financial instruments have far more extensive guidance in respect of:

- how to measure assets and liabilities that do not pay/incur market rates of interest
- removing general bad debt provisions.

Accounting for interest free or discounted loans a requirement of AIFRS is that all loans or deposits be recorded at fair value on initial recognition. This has a major impact where non-current loans are either interest free or bear interest at a below market rate. In these instances the loan will initially be recorded at fair value, with a credit being recognised in earnings and subsequently an interest charge recognised over the life of the loan using the effective interest rate method.

AIFRS introduces a completely new standard on how to account for investment property...

Example:

Entity A receives an interest free loan of \$1,000 on 1 July 2004 repayable on 30 June 2007. Current market interest rate is 10%.

No general bad debt provisions

Bad debt provisions can only be created under AIFRS in respect of debtors for which there is indication that an event has actually occurred that indicates that the debt will not be recovered. This means that bad debt provisions cannot be created as a percentage of total debtors (general provisions). Bad debt provisions may still be determined as a percentage of overdue debtors providing there is evidence that the percentage provided for reflects historic bad debt experience.

Action Points

- Identify any long-term loans and deposits not paying market interest and determine how to account for them under AIFRS.
- Identify (and reverse) any bad debt provisions made where there is no evidence of a past impairment event occurring.

Accounting for Investment Property

AIFRS introduces a completely new standard on how to account for investment property, forcing investment property to be classified separately from other property, plant and equipment. An investment property is a property that is held to earn rental income or for capital appreciation, rather than being used in the production or supply of goods and services or for sale in the ordinary course of business. It also excludes owner-occupied property.

The new standard requires entities to either:

- have investment property fair valued annually with all movements in value being recorded in the income statement; or
- record the investment property at cost and depreciate the property over its useful life.

..grants received by not-for-profit entities are generally accounted for when cash is received...

If the fair value model is adopted, then:

- the investment property must be fair valued at each reporting date
- all increments/decrements in the fair value of investment property must be recognised in the income statement (not in asset revaluation reserves as was previously common practice).

Action Points

- Identify which properties may be investment properties.
- Determine which accounting treatment to use
 - fair value or amortised cost. An entity must use the same method for all investment properties.
- If an entity adopts the fair value model:
 - Determine the fair value as at 30 June 2004, 2005 and 2006.
 - Transfer any balances of revaluation reserves at 30 June 2004 to retained earnings.
 - Restate 30 June 2005 results for the movement in fair value from 30 June 2004 to 30 June 2005.
 - Determine the profit/loss impact in 2006 of increases/decreases in fair value from 30 June 2005 to 30 June 2006.
- If an entity adopts the cost model:
 - Determine amortisation period.
 - Commence depreciation, if required, restating prior year comparatives.

Government Grants

When accounting for government grants, AASB 120 Accounting for Government Grants and Disclosure of Government Assistance, does not apply as this Standard relates only to for-profit entities. Government grants must be accounted for under AASB 1004 Contributions, which requires that they be recognised when the not-for-profit entity obtains control of the contribution or the right to receive the contribution. This means that grants received by not-for-profit entities are generally accounted for when cash is received, unless there are conditions associated with the grant that require repayment if the grant is not spent according to the conditions of the grant and it can be demonstrated that the donor is likely to demand repayment.

The adoption of AIFRS introduces a number of new disclosure requirements...

Example 1:

- Charity A receives an annual government grant to run a “meals-on-wheels” programme for the homeless.
- A condition of the grant is that the money is to be returned if it has not been spent by the end of the financial year.
- An annual grant certificate is required to be submitted to the government agency in charge of the grant and any surplus funds have to be repaid.
- Charity A only has control over the grant as funds are spent. This means that the grant is not recognised as income until funds have been spent, e.g. on a monthly basis.

Example 2:

- Same facts as in Example 1 except that in the past the government agency has made no attempt to recover unspent monies.
- The grant is recognised as income when the cash is received because Charity A has control over the contribution.

Action Points

- Analyse the terms of all government grants received since AIFRS transition.
- Assess whether revenue should be recognised when cash is received or as the conditions of the grant have been met.

New disclosure requirements

The adoption of AIFRS introduces a number of new disclosure requirements and presentation, the key impacts being:

- disclosure of key accounting estimates
- disclosure key areas of accounting judgement
- renaming of primary statements, e.g. balance sheet and income statement
- new primary statement being statement of changes in shareholders' equity.

In situations where not-for-profit entities hold assets to generate cash (eg shop fittings), then the normal impairment testing rules apply...

Action Points

- Draft 2006 financial statements now.
- Determine disclosure for key accounting estimates and judgement.
- Redraft accounting policy notes so all policies are AIFRS compliant.

Defined Benefit Superannuation

Plans Until the introduction of AASB 119 Employee Benefits, Australian entities recognised the cost of a pension based on the contributions paid into the fund. AASB 119 introduces significant changes in the accounting for defined benefit superannuation plans, requiring that the deficit/surplus of the fund be recognised as a liability/asset on the balance sheet of the entity sponsoring the fund. This could significantly impact the balance sheets of a number of not-for-profit entities and could increase volatility in reported earnings as a result of movements in the superannuation fund's funding status.

Impairment testing

Not-for-profit entities must apply the measurement requirements of the new impairment Standard AASB 136 Impairment of Assets, recognising that there are significant differences in respect of how a not for profit entity impairs an asset where the primary purpose is not to generate cash (but is instead held in order for the entity to satisfy its not-for-profit objectives), and how a not-for-profit entity impairs assets held to generate cash. For an asset not held to generate cash, its recoverable amount is its depreciated carrying value if the asset would be replaced should the entity be deprived of the asset. This means that fixed assets will be written off/ impaired in situations where the asset is obsolete, or not being utilised, (i.e. if an asset would not be replaced if it were lost or destroyed, it is impaired). In situations where not-for-profit entities hold assets to generate cash (eg shop fittings), then the normal impairment testing rules apply (impairment "triggers").



Related links

[BDO Kendalls Not-for-profit](#)

Inventory

Not-for-profit entities have special requirements when accounting for inventory acquired for no cost (i.e. donations). Inventory acquired for no cost must be carried at current replacement cost. Inventory held for distribution (as opposed to for-profit sale) must be valued at the lower of cost or current replacement cost.

About the author

Lisa Bundesen is a Partner in the Forensic Accounting Division in Brisbane. Lisa has extensive experience in both the prosecution and defence of proceed matters having spent almost five years as an Investigative Accountant with the Queensland Police Service and work with lawyers to have assets released from restraining orders.

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