Not-for-profit financial reporting and tax update

January 2020

Building a better working world

Not-for-profit update - financial reporting

Financial reporting for Not-for-Profits (NFP entities) continues to be an area of focus for the Australian Accounting Standards Board (AASB). We also continue to see developments in taxation law for NFP entities. We outline the latest developments in financial reporting and tax below. Please contact your EY advisor for further details.

	Detail	Status	Impact
Leases (new standard)	▸ This standard was issued in February 2016, and replaces the existing AASB 117 *Leases* ▸ AASB 16 provides a single model for accounting for leases by lessees. Leases other than low value and short-term leases must be recognised on the balance sheet of lessees. The lessee will recognise an asset, reflecting its right to use the underlying asset, and a liability, in respect of its obligation to make lease payments ▸ Expenses in respect of leases will include amortisation of the right-of-use asset and interest expense in respect of the lease liability ▸ Lessors will continue to account for leases as either operating or finance leases, consistent with current practice	▸ AASB 16 Leases ▸ The new Standard is effective for annual periods beginning on or after 1 January 2019	▸ For all entities with current operating lease arrangements, lease liabilities and right-of-use assets will be brought onto the balance sheet (subject to limited exemptions) ▸ The timing and nature of expenses recognised in profit or loss will change ▸ All service arrangements will need to be revisited to determine if they contain leases e.g. data management services, transport services
Deferral of application date for Service Concession Standard (Grantors)	▸ AASB 1059 *Service Concessions Arrangements: Grantors* was originally applicable to annual reporting periods beginning on or after 1 January 2019 ▸ The AASB has issued an amending standard deferring the application date by one year to 1 January 2020	▸ AASB 2018-5 *Amendments to Australian Accounting Standards - Deferral of AASB 1059* has been released in November 2018	▸ Government grantors will have an additional year to implement the new standard ▸ Main impact will be on government entities granting rights to build and/or operate infrastructure assets involving a public service, such as hospitals, schools and roads

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Income of NFP entities (including temporary relief to not measure peppercorn leases at fair value)	▸ The new Standards will defer income recognition in some circumstances for NFP entities, particularly where there is a performance obligation or any other liability. In addition, certain components in an arrangement, such as donations, may need to be separated from other types of income and recognised immediately ▸ AASB 1058 also expands the circumstances in which NFP entities are required to recognise income for goods and services received for consideration that is significantly less than its fair value principally to enable the entity to further its objectives (discounted goods and services) ▸ AASB 2018-8 postpones the requirement for NFP entities to recognise peppercorn leases at fair value. Applying the temporary relief, NFP entities can measure right of use assets associated with peppercorn leases at the present value of payments required. If they choose to apply the deferral option, specific disclosures need to be made to explain the effects of peppercorn leases ▸ AASB 1004 will continue in force but with its scope restricted to specific issues for government entities and contributions by owners ▸ AASB 2019-6 gives a 6 month deferral of the application of AASB 1058/15 in relation to research grants only, from periods beginning on or after 1 January 2019 to periods beginning on or after 1 July 2019, with earlier application permitted, to provide further education to address the continuing divergent views on revenue recognition for research grants	▸ AASB 1058 *Incomeof Not-for-ProfitEntities* and AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* , and revised AASB 1004 issued in December 2016 ▸ The new and revised Standards apply to accounting periods beginning on or after 1 January 2019 ▸ AASB released a AASB Staff FAQ which addresses questions specific to NFP entities ▸ AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* is also effective beginning on or after 1 January 2019	▸ Depends on how an NFP entity currently applies AASB 1004 ▸ Timing and amount of revenue/grants to be recognised by an NFP entity may be impacted. We expect this will result in more deferral of revenue ▸ Clearer guidance for deferral of revenue from some transactions where sufficiently specific goods/services are promised (referencing the AASB 15 requirements) ▸ Peppercorn transition relief avoids the income statement reflecting a large income item in the year a new peppercorn lease is signed ▸ Entities will need to make an accounting policy choice in relation to peppercorn leases, and monitor developments for an end date to transition relief ▸ Entities, such as universities and medical research organisations, which receive research grants will continue to account for them in accordance with existing practice for financial reporting periods ending December 2019.NFPs with June year end will be unaffected by the deferral

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	Detail	Status	Impact

Licenses issued by NFP Public Sector Licensors	▸ AASB 2018-4 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Public Sector Licensors* provides guidance for NFP licensors in accounting for the issue of licenses (for example, gambling, driving, fishing licences)
	▸ The Standard amends AASB 15 to:
	  ▸ Expand its scope to cover non-contractual licences
	  ▸ Provide guidance to distinguish licences from taxes, for example, a tax will:
	    ▸ Be compulsory rather than discretionary
	    ▸ Be intended to generate income rather than have a non financial purpose such as equitable allocation of resources
	    ▸ Not grant any specific rights to the payer or obligations for the recipient
	  ▸ Clarify types of licences issued by NFP public sector licensors, and
	  ▸ Provide guidance to assist in clarifying performance obligations relevant to such licence arrangements
	▸ The Standard also amends AASB 16 to clarify that licenses that are in substance leases or contain leases, except intellectual property, fall within the scope of AAAB 16
		▸ The new Standard is applicable to annual periods beginning on or after 1 January 2019
		▸ Early application is permitted
			▸ Government departments and other NFP public sector entities issuing licences will be required to determine whether they will be impacted by these changes
			▸ Where no separate performance obligations exist from the transfer of the licence, the licence fee will be required to be recognised as revenue at the time of issue. This may result in a change in accounting to the extent that such revenue is currently deferred and recognised over the licence period
			▸ The Standard clarifies that performance obligations do not include activities that a licensor must undertake to fulfil a contract unless those activities transfer a good or service additional to the licence. For example: a promise that the right is restricted to the licensee; activities that a licensor is required to undertake to benefit the general public such as 'policing' activities; or activities that a licensor performs to check that a licensee continues to meet the eligibility criteria of the licence, are not performance obligations
			▸ Certain non-IP licence arrangements that arise due to statutory requirements may involve granting a licensee rights over an identified asset/s. Arrangements that are in substance leases or contain leases will be required to be accounted for in accordance with AASB 16
			▸ The Standards' classification of licences and taxes differs from the Government Financial Statistics (GFS) guidance. Entities need to be conscious of these differences when reporting on licences and taxes
			▸ A practical expedient is provided over the recognition of short-term (less than 12 months) and low value licences, so accounting for those types of licences may not be effected

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Exposure Draft ED 291 ***Not-for-Profit Entity Definition and Guidance***	▸ Currently, several Australian Accounting Standards include the definition of a NFP entity as one whose "principal objective is not the generation of profit". Entities which meet this definition apply modified accounting requirements in certain areas, e.g. inventory and fixed assets ▸ ED 291 proposes a revised definition of Not-for-Profit, based on the New Zealand definition of Public Benefit Entity ▸ Under the ED, a NFP entity is one "whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders…" ▸ The ED provides several illustrative examples	▸ Deadline for comments closed September 2019. AASB considering comments	▸ All NFP entities will need to revisit their assessment of whether they meet the new definition of NFP entity which will allow them to continue to apply NFP accounting requirements ▸ Certain member based organisations may find that if the benefits they provide are restricted to members, as opposed to providing benefits to the broader community, they may not fall within the revised definition. Going forward, such entities would need to apply the general for profit entity rules

Other AASB reporting initiatives affecting NFP:
▸ ***ED 293 amending AASB 1054 Australian Additional Disclosures***
▸ ***ED 295*** **Simplified Disclosures for Tier 2 Entities**
	ED 293 proposes additional disclosures for entities (both FP and NFP) preparing Special Purpose Financial Reports, including:
	▸ information about how the decision to prepare special purpose reports was made
	▸ whether all subsidiaries and associates have been consolidated
	▸ whether any recognition and measurement requirements have not been complied with and, if not, an indication of where they do not comply
	ED 295 proposes replacing the current RDR framework with a new tier 2 disclosure framework with all the disclosure requirements for Tier 2 entities combined in one (new) standard. The disclosures have been developed using IFRS for SMEs as a base however certain disclosures have been added, removed or amended compared to this.
		▸ ED 293 - Comments closed 19 August 2019
		▸ ED 295 - **Comments closed** 15 November 2019
			▸ All NFP entities will need to:
			  ▸ consider and plan for disclosure changes
			  ▸ engage with stakeholders to communicate the possible changes
			  ▸ update assessments of controlled entities and associates/joint venture relationships

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	Key impacts	Status
External conduct standards	External conduct standards (ECS) for charities registered with the ACNC came into effect on 23 July 2019. Charities will need to comply with the ECS when operating outside Australia.: ► ECS sets minimum standards for conduct, governance and behaviour that ACNC registered charities must adhere to when operating overseas or when partnering with others to operate overseas. ► The ECS are intended to provide greater confidence to the public that funds sent outside Australia are being used for legitimate purposes. ► The ECS assist in meeting Australia's international obligations including under the Financial Action Task Force Recommendations.	► Date of effect: 23 July 2019
Deductible Gift Recipient (DGR) reform	On 22 August 2018, Treasury released a consultation paper on the Government's proposed DGR reforms. The consultation paper covers the following: ► The requirement for non-government organisations with DGR status to register as a charity with the ACNC from 1 July 2020 ► Transition arrangements to support existing organisations with DGR status to register as a charity with the ACNC ► The Commissioner's discretion to exempt organisations with DGR status from the requirement to register as a charity in specific circumstances ► The abolition of certain public fund requirements	► Consultation process now complete. ► Date of effect: 1 July 2020 (extended from 1 July 2019).

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	Key impacts	Status
TR 2019/6 finalises Draft Taxation Ruling 2018/D1	On 18 December 2019 the ATO released Taxation Ruling *Income Tax: the 'in Australia' requirement for certain deductible gift recipients and income tax exempt entities* ("TR 2019/6"). This new ruling finalised the draft ruling 2018/D1. This ruling provides the Commissioner's views on the following conditions in ITAA97: ▸ The condition that certain DGRs be 'in Australia' before a gift or contribution to them is tax deductible ▸ The condition that certain entities have a 'physical presence in Australia' before their income is exempt from tax ▸ The condition that a registered charity or DGR have a 'physical presence in Australia' before they qualify for a refund of franking credits Under the ordinary meaning of the word, an entity is "in Australia" if it is established or legally recognised in Australia and it operates in Australia at that time. The Commissioner is of the view that an entity will not operate in Australia if the management and operational decisions occur outside of Australia. To have a physical presence in Australia, an entity must conduct physical operations in Australia. The mere ownership of property in Australia does not constitute having a 'physical presence' in Australia. The entity must also incur its expenditure and pursue its objectives principally in Australia and the location where this occurs is very fact dependent. An entity must continue to satisfy the "in Australia" requirements to maintain their Division 50 income tax exemption. The ruling provides a number of examples for organisations to consider.	▸ Date of effect: applies to years of income commencing both before and after its date of issue.
ACNC Annual report	The ACNC annual report for 2018-2019 was released in October 2019. The report highlights ACNC's dedication to ensure charities meet their obligations under the ACNC Act and Governance Standards. Throughout the year there was a 24% increase in concerns raised about charities, 100 investigations (down from 108 in 2018) conducted, and 12 revocations of charity registration. These organisations will lose access to Commonwealth charity tax concessions (income tax exemption, FBT concessions and GST concessions).	▸ Ongoing.

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ATO activity and enforcement powers	Increased ATO activity is expected and is happening due to the Government's increased funding to the ATO to target tax avoidance and ensure Justified Trust (particularly in relation to Significant Global Entities – "SGEs"). Two key areas of interest are: ► The ATO has been encouraging larger taxpayers to adopt the Tax risk management and governance review guide and embrace tax risk management as part of good corporate governance. We anticipate the ATO to extend its focus on tax risk management and governance practices (at least to some extent) to all taxpayers in future years. ► The ATO has begun issuing penalty notices to SGEs for failing to lodge any form type. We recommend you ensure all tax reporting obligations are up-to-date.	► Ongoing.
Corporate income tax rate decrease	Corporate income tax rates have been reduced for some taxpayers where they meet the definition of a base rate entity. This is relevant for taxable not for profit entities and requires that the entity meet an aggregate turnover threshold test and 80 percent or less of their assessable income is base rate entity passive income. Importantly, the principle of mutuality does not reduce an entity's income for the purposes of the turnover threshold. The base rate is also the rate at which taxable income (over $832) is taxed at for all other not-for profit companies. The below table sets out the rates and turnover thresholds for the next few years	► Ongoing.

Income Year	Turnover threshold	Base rate
2017-18	$25m	27.5%
2018 - 2019 to 2019 - 2020	$50m	27.5%
2020 - 2021	$50m	26%
2021 -2022	$50m	25%

EY experienced Australian NFP team

Sydney

John Robinson
Partner – Assurance, Ernst & Young
Tel: +61 2 8295 6536
John.robinson@au.ey.com

Anne-Marie Johnson
Director - IFRS Professional Practice, Ernst & Young
Tel: +61 2 9248 5537
anne-marie.johnson@au.ey.com

Jason Wrigley
Partner – Tax, Ernst & Young
Tel: +61 2 9248 5303
jason.wrigley@au.ey.com

Amanda Spinks
Director – Employment Taxes, Ernst & Young
Tel: +61 2 9248 4716
amanda.spinks@au.ey.com

Melbourne

Sue Williamson
Partner – Tax, Ernst & Young
Tel: +61 3 9288 8917
sue.williamson@au.ey.com

Stuart Painter
Partner – Advisory, Ernst & Young
Tel: +61 3 9288 8622
stuart.painter@au.ey.com

Russell Phillips
Partner – Tax, Ernst & Young
Tel: +61 3 9655 2696
russell.phillips@au.ey.com

Paul Gower
Partner – Assurance, Ernst & Young
Tel: +61 3 9288 8218
paul.gower@au.ey.com

Georgina Dellaportas
Associate Partner – IFRS Professional Practice, Ernst & Young
Tel: +61 3 9288 8621
georgina.dellaportas@au.ey.com

Canberra

Todd Wills
Partner – Tax, Ernst & Young
Tel: +61 2 62673876
todd.wills@au.ey.com

Ben Tansley
Partner – Assurance, Ernst & Young
Tel: +61 2 6267 3933
ben.tansley@au.ey.com

Matthew Whittaker
Senior Manager – Tax, Ernst & Young
Tel: +61 2 6267 3977
matthew.whittaker@au.ey.com

Perth

Rob Kirkby
Partner – Assurance, Ernst & Young
Tel: +61 8 9217 1298
robert.kirkby@au.ey.com

Timothy Dachs
Partner – Assurance, Ernst & Young
Tel: +61 8 9429 2111
timothy.dachs@au.ey.com

Philip Teale
Partner – Assurance, Ernst & Young
Tel: +61 8 9429 2442
philip.teale@au.ey.com

Jemma Newton
Partner – Assurance, Ernst & Young
Tel: +61 8 9429 2222
jemma.newton@au.ey.com

Adelaide

Alison Dobbie
Senior Manager – IFRS Professional Practice, Ernst & Young
Tel: +61 8 8417 1561
alison.dobbie@au.ey.com

Brisbane

Kellie McKenzie
Partner – Assurance, Ernst & Young
Tel: +61 7 3011 3333
kellie.mckenzie@au.ey.com

Kylie Meaney
Director – Financial Accounting and Advisory Services, Ernst & Young
Tel: +61 7 3011 3379
kylie.meaney@au.ey.com

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