Changes to revenue recognition for not-for-profits – What does it all mean?

The AASB recently released **Exposure Draft 260 Income of Not-for-Profit Entities** (the ED). The ED proposes changes to the recognition, measurement and disclosure of income of Australian not-for-profit entities in the public and private sector. This publication focuses on the key changes proposed for not-for-profit entities in the private sector.

The proposals aim to:

- better align not-for-profit revenue recognition to the new revenue standard, AASB 15 *Revenue from Contracts with Customers* (AASB 15) for for-profit entities, and
- address concerns that the current revenue recognition guidance for not-for-profits in AASB 1004 *Contributions* (AASB 1004) results in premature recognition of revenue in some cases.

So, what might this mean for private not-for-profit entities? Initially, entities would need to decide whether the income received is a donation, a contract with a customer or a combination of both. This decision will drive the timing of recognition if the proposals are implemented. Donations would be accounted for in a similar way to how they’re accounted for today – recognised as income upon attaining control over the donation. However, revenue that is like revenue received from a customer may be recognised later than what we are used to today. There is also new guidance on volunteer services, non-cash donations and disclosures. In this article, we work through the proposed new model and discuss some of the ways in which it’s different to the model in use today.

Where do I start…is there a contract with a customer?

Under the proposed new model, entities would first determine whether the income received is that of a contract with a customer, a donation or a combination of both. A contract with a customer would exist if the following two criteria have been met:

1. the entity has a legally **enforceable contract** with a customer, and
2. that contract includes **“sufficiently specific” promises** for the not-for-profit entity to transfer goods or services to the customer or third party beneficiaries.

If these two criteria have been met, revenue would be recognised in accordance with the new implementation guidance for not-for-profits that is expected to be included in AASB 15. In determining whether promises are sufficiently specific, not-for-profits would need to consider indicators such as whether there is enough detail in the contract regarding the nature of the good/service they’re providing, the cost or value of the good/service, the quantity of the good/service and the period of time over which the good/service will be transferred. Judgement will be required in assessing these indicators. However, the ED does specify that a requirement to use assets for general purposes within a certain time period is not, in and of itself, a sufficiently specific promise to qualify as a contract with a customer. See Examples 1 and 2 below.
Why does it matter if I have a contract with a customer?

If a contract with a customer exists, the guidance in AASB 15 would be followed. Revenue would be recognised as the promise made to the customer would have been satisfied. In most cases, this would result in a later recognition of revenue than occurs under the control model that we use today in accordance with AASB 1004.

If a contract with a customer does not exist, the arrangement would be accounted for under the new AASB 10XX, which would replace AASB 1004. The criteria for recognition are similar to those in AASB 1004. Under AASB 10XX, an entity would recognise income when it obtains control over a resource; it is probable the entity will receive future economic benefits; and the fair value can be reliably measured.

AASB 10XX would require an asset received to be measured at fair value – even if non-cash. If an entity purchases an asset for less than its fair value, income may need to be recognised for the differential if the seller intended to make a donation. An exception is included if the donation is non-cash and is not material at an individual transaction level.

Example 1
Scenario: A charity is contracted to operate dwellings for the homeless, including providing counselling and other services to inhabitants. The charity receives $15m on 15 June 20X1 to provide counselling services to inhabitants for a specified number of hours/week. The funds must be refunded if not spent prior to 30 June 20X2.

Applying new model: The charity would account for the $15m payment in accordance with AASB 15 as there is an enforceable contract (i.e. they must refund the money if services are not provided) and the agreement is sufficiently specific as to the nature of the services to be provided and the time period in which the services must be performed. A contract liability for $15m would be recognised on receipt and the revenue would be recognised when promised services are performed.

Example 2
Scenario: As above, but the funds only have to be spent on the charity’s overall objectives.

Applying new model: While this contract creates enforceable rights, the agreement does not contain a sufficiently specific promise to the customer. A time period restriction in and of itself is not sufficient. The charity would likely recognise income immediately on obtaining control of the donation in accordance with the new guidance in AASB 10XX.

What if there is a donation component in a contract with a customer?

If a not-for-profit decides that a transaction should be accounted for in accordance with AASB 15, it needs to work out whether there is a separately identifiable donation component that is material to the individual contract. If so, the contract may need to be separated into its different elements: the donation component would be recognised in accordance with AASB 10XX and the specific promise would be recognised in accordance with AASB 15. For a donation component to be accounted for separately, there must be evidence that:

- the customer intends to make a donation and
- the donation element is separately identifiable from the goods or services.

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<th>Examples of evidence of intention to make a donation:</th>
<th>Required criteria for separate identification of donation:</th>
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<td>- the consideration is promised as part of a fund-raising event</td>
<td>- there is evidence that part of the consideration is not for payment for the good/service</td>
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<td>- the consideration is tax deductible</td>
<td>- the consideration is not refundable if the good/service is not delivered</td>
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<td>- the consideration is increased specifically for the purpose of making a donation</td>
<td>- the donation can be reliably measured</td>
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<td>- there is a substantial difference between the consideration and stand-alone selling price of the delivered good/service</td>
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See Examples 3-5 below, which illustrate the above concepts.

Example 3
Scenario: A charity sells tickets to a fundraising event above the commercial selling price. A portion of the ticket price, which is material on a contract level, is not refundable if the event does not take place.

Applying new model: The non-refundable portion would be treated as a donation and accounted for under AASB 10XX. The portion that is refundable if the event is not hosted would be accounted for under AASB 15. If no portion was refundable or the amount refundable was immaterial on a contract level, the entire amount would be accounted for in accordance with AASB 10XX.

Example 4
Scenario: An entity purchases land with a fair value of $1m from a benefactor for $100,000.

Applying new model: The entity will initially recognise the land at $1m, a reduction in cash of $100,000 and donation income of $900,000. The transaction would be accounted for in accordance with AASB 10XX as it is not a contract with a customer.

Example 5
Scenario: A charity receives donated clothes for resale. The donations are not individually material.

Applying new model: The charity would recognise revenue when the clothing is sold in accordance with AASB 10XX.

Is there anything else I need to consider?
The ED also addresses certain other areas as outlined below.

Volunteer Services
AASB 1004 is silent as to whether private not-for-profits should recognise the value of volunteer services. The ED proposes that not-for-profits have a policy option to account for donated services at fair value – if the fair value can be reliably measured.

Unit of Account
A donation component would be accounted for separately if it is material at a contract or transaction level (e.g. donated inventory, assets purchased at less than fair value, assets sold above commercial selling prices). However, entities would not need to consider materiality of contributions at an aggregate level. See Example 5 above.

Disclosures
The ED does not exclude not-for-profits from applying the disclosure requirements of AASB 15. Further, AASB 10XX includes some incremental disclosures on the disaggregation of recognised income into categories that illustrate their nature (e.g. grants and volunteer services) and information about related recognised assets and liabilities.

What should I do now?
If the proposals in ED 260 are adopted, all not-for-profit entities will need to assess the impact. In some cases, the changes required could be significant. Now is the time to consider the potential impact of the proposed changes and reach out to the AASB or your PwC contact to share your feedback.