Issues Paper: Identification and Recognition of Donations in the AASB ED on Income from Transactions of Not-for-Profit Entities

Introduction

1 This paper discusses significant issues arising in the staff's drafting of the forthcoming ED on Income from Transactions of Not-for-Profit Entities, in relation to the identification and measurement of donation components of contracts with customers.

2 This paper is organised as follows:

(a) the meaning of a 'donation' and some challenges in accounting for donations (paragraphs 3–7);

(b) indicative factors that might be used to identify whether a contract with a customer includes a donation component (paragraphs 8–11);

(c) possible recognition criteria for identified donation components of contracts with customers (paragraphs 12–23);

(d) specific measurement issues (paragraphs 24–33);

(e) conditionally refundable donation components (paragraphs 34–42); and

(f) whether any exemptions should be provided from recognising donation components of contracts with customers for cost-benefit reasons (paragraphs 43–49).

Background

Meaning of 'donation' and challenges in accounting for donations

3 In the context of the broad scope of the draft ED (i.e. all income from transactions of NFP entities[1], which includes revenue from contracts with customers and other income), a donation is an inflow of economic benefits (whether in the form of an increase in an asset or a reduction in a liability) without a corresponding outflow of economic benefits (whether in the form of an increase in a liability or a reduction in an asset). In the narrower context of revenue from contracts with customers, a donation is an amount of consideration that is not attributable to any goods or services that may be promised by the entity in a contract.

4 As mentioned in paragraph 1 above, this paper focuses on donation *components* of contracts with customers. (Whenever a donation is a component of a contract—i.e. the contract also includes promises to transfer goods or services—the contract is with a customer.) With the exception of the 'materiality' issue discussed in

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[1] However, the ED would not apply to transactions and events giving rise to revenue or other income recognised under the requirements of another Australian Accounting Standard.

paragraphs 46 – 49 below, the issues in this paper do not arise when a transfer of assets to the entity does not give rise to a performance obligation or another obligation such as a refund obligation (the transaction is entirely composed of either a donation, in the case of voluntary transfers, or a tax or fine, in the case of involuntary transfers). For example, when the transaction is entirely composed of a donation, the donation is directly identifiable and would be measured faithfully at the amount of the consideration received or receivable.

5 In respect of contracts with customers, the Board had tentatively decided that the existence and amount of a donation component would be determined by reference to the amount of the consideration promised by the customer and the sum of the stand-alone selling prices of the goods or services promised in the contract. However, staff note that adopting a primarily 'measurement-driven' approach to identifying whether a contract with a customer includes a donation component would create a risk that donation components would be identified when none in fact exist (the problem of 'false positives'). This is because, in numerous situations, a measurement difference between the promised consideration and the sum of the stand-alone selling prices of the promised goods or services might not reflect the existence of a donation component but instead could be explained by:

(a) information asymmetry or differences in the bargaining power of the contracting parties, which results in the customer agreeing to a 'bad' deal (because the customer promises to pay an amount of consideration that exceeds the ordinary selling prices for the promised goods or services); or

(b) variations in the estimated stand-alone selling prices of the promised goods or services that arise because of the assumptions or adjustments made so that the estimate reflects the specific circumstances of the contract with the customer.

6 To address the difficulties with faithfully identifying donation components of contracts with customers described in paragraph 5 above, AASB staff recommend emphasising in the ED that identifying whether a contract with a customer includes a donation component should involve a qualitative assessment, based on the available evidence, of whether there is an intention to provide a donation to the entity. This is discussed in paragraphs 8 – 11 below.

Significant Issues

Identifying Donation Components

Qualitative assessment of whether a contract includes a donation component

7 The draft minutes of the Board's September 2014 meeting indicate the Board tentatively decided:

> "to amend its draft proposal that would have required any donation component of a contract to be accounted for separately as income when the donation is received or receivable, regardless of the nature of the evidence for the existence and amount of such a component."

8 To address the Board's tentative decision, AASB staff recommend emphasising that identifying whether a contract with a customer includes a donation component should

involve a qualitative assessment, based on the available evidence, of whether there is an intention to provide a donation to the entity. That evidence could include:

(a) the goods or services are promised as part of a fundraising event being held by the entity;

(b) a portion of the consideration is identified as being a tax deductible donation; or

(c) an invitation to the customer to increase the amount of promised consideration specifically for the purposes of providing a donation to the entity (e.g. when a membership subscription form for services provided by a NFP entity, such as a heritage trust, invites members to make a donation for a nominated amount).

9 Conversely, if all previous contracts with the customer have been conducted on a purely commercial basis, and there is no indication of any change in the entity's relationship with its customer, this would be a strong indication that the contract has no donation component.

10 If there is no qualitative evidence to suggest an intention of the customer to provide a donation, a measurement difference between the promised consideration and the entity's initial estimate of the stand-alone selling price of all the promised goods or services should cause the entity to investigate further whether those stand-alone selling prices have been estimated faithfully (including assessing whether any promises to provide to goods or services have been overlooked). For example, on closer examination, the entity might conclude that a stand-alone selling price estimated using an adjusted market assessment approach or an expected cost plus a margin approach (see paragraphs 79(a) and (b) of IFRS 15) includes adjustments or margins that do not faithfully represent the stand-alone selling price for the good or service. This notion of reassessing whether a measurement difference represents a donation component is akin to the requirement in paragraph 36 of AASB 3 *Business Combinations* to reassess the identification of all acquired assets and assumed liabilities before recognising a gain on a bargain purchase.

Question for Board members

Q1(a) Do you agree with the AASB staff recommendation that identifying whether a contract with a customer includes a donation component should be based on a qualitative assessment, based on the available evidence, of whether the customer intended to provide a donation to the entity (see paragraph 8 above)?

Q1(b) Do you agree with the factors proposed in paragraph 8?

Recognition and Measurement of Donation Components

Should an identified donation component be subject to recognition criteria?

11 The draft minutes of the Board's September 2014 meeting indicate the Board tentatively decided:

> "to explore an approach under which a NFP entity would be required to account separately for a donation component of a contract only if a particular evidence threshold is met (e.g. the

stand-alone selling prices of all of the promised goods or services in the contract are observable)."

12 In relation to this tentative decision, meeting a particular evidence threshold could involve a qualitative assessment like that discussed in paragraphs 8 – 11 above, or an 'observable prices' requirement (discussed in paragraphs 14 – 23 below), or a combination of both.

13 The main reason for exploring an approach that only required the identification of a donation component if there was evidence in the form of observable stand-alone selling prices of all the goods or services promised in a contract was that the risk of 'false positives' in identifying such components might be relatively low (e.g. compared to when entity-specific inputs are used to estimate stand-alone selling prices of some or all promised goods or services in the contract).

14 However, the risk of 'false positives' in identifying donation components is a reason for considering what evidence is necessary for separately recognising a donation component of a contract with a customer. The approach referred to by the Board in paragraph 12 above would still have permitted entities to *elect* to recognise a donation component when the stand-alone selling price of all of the promised goods or services in the contract is not observable.

15 An issue for the Board to consider is whether a qualitative assessment of whether a contract with a customer includes a donation component (the 'identification' step—discussed in paragraphs 9 – 11 above) should be buttressed with criteria for separate recognition of a donation component, to limit the risk of 'false positives' in recognising donation components. If so, one approach the Board could consider is adopting a recognition criterion for donation components of contracts with customers that there must be an observable price (or at least observable inputs to determining that price) for the bundle of goods or services promised in the contract.

16 AASB staff note that requiring observable prices or inputs for recognising donation components (which would often be recognised as income immediately—i.e. on 'day one') would be broadly consistent with the stipulation in paragraph B5.1.2A of AASB 9 *Financial Instruments* that 'day one' gains/losses on initial recognition of financial assets and financial liabilities arising from differences between the transaction price and fair value may only be recognised when the fair value is based on a Level 1 input or data from observable markets[2].

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[2] Paragraph B5.1.2A of AASB 9 states that: "The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also AASB 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

(a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a

17 However, IFRS 15 does not specify a hierarchy of stand-alone selling prices and does not prevent the transaction price from being allocated to performance obligations for goods or services that have stand-alone selling prices without observable inputs. Because a donation component is simply another economic phenomenon within the contract, in addition to the promised goods or services, AASB staff think a higher recognition threshold should not apply to revenue from a donation component than revenue from transferring a good or service to the customer.

18 Under IFRS 15, after identifying the performance obligations in the contract (the economic phenomena), an entity determines the transaction price and allocates the transaction price to each performance obligation; recognition of revenue is the final step (occurring when promised goods or services are transferred to the customer). AASB staff think the same role for recognition should apply to contracts with customers including donation components; the donation component is another economic phenomenon to account for analogously to performance obligations. More specifically, under IFRS 15, revenue is recognised when the entity satisfies a performance obligation by transferring control of a good or service to a customer. In the case of donation components, the entity has no performance obligation to satisfy and therefore would be able to recognise revenue when the entity recognises the donated asset(s) [subject to the question of contingently refundable donation components[3]]. Thus, staff think the logic of IFRS 15 works well in relation to donation components, including the role of recognition.

19 AASB staff think that limiting recognition of donation components of contracts with customers to when there are observable prices or inputs for determining the aggregate stand-alone selling price of all of the promised goods or services in the contract would be unduly restrictive. Paragraph 77 of IFRS 15 states that:

> "… The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service."

Consequently, when NFP entities have only a single customer for a particular good or service (as might occur when the NFP entity supplies that good or service to the government), specifying a recognition criterion limited to observable prices or inputs arguably would not result in recognition of donation components identified in respect of those contracts on the basis of a qualitative assessment.

20 Furthermore, an 'observable prices or inputs' recognition criterion would put pressure on the determination of what an observable price is.

21 For the reasons discussed in paragraphs 18 – 21 above, AASB staff think a qualitative assessment of whether a contract with a customer includes a donation component should not be buttressed with criteria for separate recognition of a donation component. AASB staff think IFRS 15 provides appropriate guidance for allocating

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change in a factor (including time) that market participants would take into account when pricing the asset or liability."

3 See the discussion of such contingencies in paragraphs 34 – 42 below.

the customer consideration to the promised goods or services and any donation component of a contract with a customer. Some key paragraphs of IFRS 15 particularly related to this allocation process are set out in Appendix A to this paper.

22 AASB staff note in particular that paragraph 78 of IFRS 15 states that: "When estimating a stand-alone selling price, … an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances." Thus, although observable inputs are not required, they are preferred to other inputs when they are available.

Question for Board members

Q2 Do you agree with the AASB staff recommendation that a qualitative assessment of whether a contract with a customer includes a donation component [the subject of Question 1] should not be buttressed with criteria for separate recognition of a donation component (see paragraph 22 above)?

Specific measurement issues

Whether to prohibit NFP entities from applying the residual approach to determine the stand-alone selling price of a good or a service in a contract

23 Paragraph 27(a) of Agenda Paper 19.2 for the Board's September 2014 meeting [Meeting 140][4] noted an option to prohibit NFP entities from applying the residual approach to estimating the stand-alone selling price of a good or service when a contract has more than one performance obligation, which is set out in paragraph 79(c) of IFRS 15. The reason for such a prohibition is a concern that applying paragraph 79(c) of IFRS 15 when estimating the stand-alone selling price of each good or service promised in a contract arguably would inappropriately preclude the identification and recognition of any donation component of the contract (i.e. it would reflect a concern that an amount that might otherwise be identified as a donation component would be subsumed within the stand-alone selling price of a promised good or service estimated using a residual approach). The Board did not make a decision on this argument, since it directed staff to develop a suggested approach to the more fundamental issue of identifying whether a contract with a customer includes a donation component.

24 After further consideration of the issue, AASB staff think it would be inappropriate to preclude NFP entities from applying the residual approach in IFRS 15 referred to in paragraph 24 above. This is because:

(a) AASB staff recommend that a qualitative assessment would be made of whether a contract with a customer includes a donation component; and

(b) once a donation component is identified, it would be measured as the amount of the consideration to which the entity expects to be entitled under the

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4 Entitled *Issues Paper: Review of AASB's Tentative Decisions regarding Not-for-Profit modifications of IFRS 15* Revenue from Contracts with Customers *that would be included in the AASB ED on Income from Transactions of Not-for-Profit Entities*

contract minus the aggregate stand-alone selling price of all of the promised goods or services in the contract.

25 The point in paragraph 25(b) above is illustrated in Example 5 in Agenda Paper 13.3. It should be borne in mind that whether a residual approach is appropriate for measuring the amount of a donation component would depend on the circumstances, having regard to the guidance in IFRS 15 on how to determine stand-alone selling prices of promised goods or services.

Question for Board members

Q3 Do you agree with the AASB staff recommendation that the ED should not propose modifying IFRS 15 to preclude NFP entities from applying the residual approach to estimating the stand-alone selling price of a good or service, in accordance with paragraph 79(c) of IFRS 15 (see paragraphs 24–26 above)?

Whether to modify the criterion in AASB 9 for potentially recognising a donation component of a contract involving a financial instrument

26 As noted in paragraph 17 above, paragraph B5.1.2A of AASB 9 *Financial Instruments* states that 'day one' gains/losses on initial recognition of financial assets and financial liabilities arising from differences between the transaction price and fair value may only be recognised when the fair value is based on a Level 1 input or data from observable markets.

27 Agenda Paper 19.3 for the AASB's September 2014 meeting [Meeting 140][5] noted the AASB's earlier tentative decision to make a limited NFP-specific amendment to paragraph B5.1.2A of AASB 9 (and a corresponding amendment to AASB 139) to state that, when a NFP recognises a financial asset or financial liability arising from a transaction that includes a donation, the donation should be recognised regardless of whether the fair value of the financial instrument is based on a Level 1 input or data from observable markets.

28 The AASB's stated reasons for this tentative decision were that:

(a) some transactions of NFP entities giving rise to financial instruments include a donation component. Recognition of such a donation component is necessary for faithful representation of the transaction; and

(b) retaining AASB 9's 'observable data' constraint on recognising 'day one' gains/losses would give rise to a significant risk that financial statements would not recognise such a donation component, because the fair value of various financial instruments with a donation component might not be based on data from observable markets.

29 The Board did not discuss at its September 2014 meeting whether to reaffirm its tentative decision to propose the NFP-specific amendment referred to in paragraph 28

[5] Entitled *Inventory of AASB's Tentative NFP Modifications of IASB ED preceding IFRS 15*

above. AASB staff think the need for that NFP-specific amendment should be discussed further before finalising the ED on Income from Transactions of NFP Entities. AASB staff are concerned that, if an estimate of the fair value of a financial instrument on initial recognition is not based (at least) on data from observable markets, there would be a significant risk that the fair value of the financial asset or financial liability (and, thus, the amount of any donation income) would not be faithfully represented.

30 An example of a financial instrument with a donation component on initial recognition is the financial liability of a charity discussed in Example 7 in Agenda Paper 13.3. If a NFP entity, such as a charity, receives a concessional loan, the fair value of the loan on initial recognition would probably be determinable at an amount different from the transaction price based on a valuation technique that uses only data from observable markets. For example, a borrowing rate applicable to that entity could be observed or derived using only data from observable markets.

31 In considering the issue discussed in paragraphs 27 – 31 above, AASB staff had regard to the treatment of 'concessionary loans' (i.e. loans granted or received at below-market terms) in IPSAS 29 *Financial Instruments: Recognition and Measurement*, which is based on IAS 39 *Financial Instruments: Recognition and Measurement*. IPSAS 29 does not include the constraint in IAS 39 (retained in IFRS 9) that 'day one' gains/losses on initial recognition of financial assets and financial liabilities arising from differences between the transaction price and fair value may only be recognised when the fair value is based on a Level 1 input or data from observable markets (see Appendix B to this paper for extracts from IPSAS 29).

32 Paragraph AG81 of the Implementation Guidance to IPSAS 29 indicates that the initial recognition and measurement of assets and liabilities resulting from non-exchange transactions is dealt with in IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. AASB staff understand that the 'off-market' portion of a concessionary loan would be treated separately from the transaction price measure of the loan and accounted for as a non-exchange transaction under IPSAS 23. Therefore, AASB staff understand that the difference between IPSASs and IFRSs is regarded as a consequence of the public-sector-specific Standard IPSAS 23. In an Australian context, accounting for the off-market portion of a concessionary loan under a different Standard than AASB 9 would be a departure from the AASB's decision to account for the recognition and measurement of financial instruments wholly within AASB 9. Accounting for a donation component of a financial asset or financial liability separately from the financial asset or financial liability would nullify any constraint over measuring the asset or liability at a different amount than its transaction price. AASB staff think that if such a constraint were to be varied for NFP entities, this should happen through explicitly modifying AASB 9 rather than treating a component of the asset or liability as falling within the scope of another Standard. Based on these considerations, AASB staff do not recommend replicating the IPSASB's approach to initial measurement of concessionary loans.

Question for Board members

Q4 Do you agree with the AASB staff recommendation to reconsider the tentatively-decided NFP-specific amendment to paragraph B5.1.2A of AASB 9 referred to in paragraph 28 above (see paragraph 30 above)? This would mean applying to NFP entities the constraint in paragraph B5.1.2A of AASB 9 that 'day one' gains/losses on initial recognition of financial assets and financial liabilities arising from differences between the transaction price and fair value may only be recognised when the fair value is based on a Level 1 input or data from observable markets.

Q5 Can you identify any examples of financial liabilities the fair value of which can be measured on initial recognition at an amount different from the transaction price without using only data from observable markets?

Conditionally refundable donation components

33 When a donation component is accounted for separately from promises to provide goods or services, it would generally be recognised as income 'immediately' (i.e. simultaneously with recognising the related inflow of assets), because the entity has no performance obligations in relation to that component. However, an issue raised at the AASB's September 2014 meeting is whether 'immediate' recognition, as income, of a donation component would be appropriate if retention of the donation were dependent on the NFP entity subsequently transferring to the customer a promised good or service (i.e. the donation component is 'contingently refundable'). This issue is discussed in paragraphs 35 – 42 below.

34 When an amount of consideration from the customer is contingently refundable, if IFRS 15 were applied to that consideration, the consideration would be identified as 'variable consideration'. This would apply, for example, to contingently refundable donation components in contracts with customers. Extracts from IFRS 15 regarding variable consideration that are particularly pertinent to contingently refundable donation components are set out below:

> "An amount of consideration can vary because of … refunds, … penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone." (paragraph 51)
>
> "If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer." (paragraph 50)

35 The estimate of variable consideration is subject to the constraint set out in paragraphs 56 and 57 of IFRS 15, which state that:

> "An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved." (paragraph 56); and

"In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

(a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

(b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.

(c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.

…" (paragraph 57)

36 Only when it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved would the contingently refundable donation component be included in the transaction price and, therefore, available for allocation to the performance obligations identified in the contract and any donation component. If consideration has already been received from the customer and the entity does not expect to be entitled to that consideration (because of the risk of a significant revenue reversal), the entity would instead recognise a refund liability for that amount in accordance with paragraph 55 of IFRS 15, which states that:

"An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (ie amounts not included in the transaction price). The refund liability (and corresponding change in the transaction price and, therefore, the *contract liability*) shall be updated at the end of each reporting period for changes in circumstances. …".

37 An example of how applying IFRS 15 would affect the treatment of a contingently refundable donation component of a contract with a customer is an annual fundraising event conducted by a NFP entity. Assume that tickets cost patrons $600 each, and are sold before the end of the reporting period, with the event held in the following period. The promised goods and services are a meal and a show. The tickets are fully refundable if the event does not proceed. Assume also that the existence of the donation component is identified on the basis of a qualitative assessment, having regard to the advertised fundraising nature of the dinner. The amount of that contingently refundable donation component is, as advertised, $250 per ticket (for simplicity, this example does not discuss how the entity assessed the reasonableness of that amount.)

38 Applying paragraphs 56 and 57 of IFRS 15 to the example in paragraph 38 above, important considerations in determining whether the estimate of the promised consideration could be included in the transaction price (i.e. whether the revenue constraint in IFRS 15 is passed) would include:

(a) the risk that the event will be cancelled and the extent to which the delivery of the event is within the control of the entity (e.g. whether there is any significant doubt over travel arrangements, such as a diplomatic row affecting cultural exchanges or a heavily booked schedule of the performers);

(b) the period of time between when the tickets are sold and when the event will be held, noting that the entity's confidence about the event being held would often be expected to increase as the event nears;

(c) the previous experiences of the entity or similar entities in holding similar fundraising events; and

(d) the fact that if the event was cancelled, all tickets would be refunded.

39 If it were concluded that, in the circumstances, the 'revenue constraint' was not passed, the consideration received would be recognised as a refund liability. The $250 per ticket donation component would be recognised as revenue at the earlier of the event being held and it becoming highly probable that that a significant reversal in the amount of cumulative revenue recognised will not occur.

40 AASB staff think there is a strong case to apply the 'revenue constraint' in paragraphs 56 and 57 of IFRS 15 by analogy to contingently refundable donation components of contracts with customers, consistent with the Board's policy decision to base its proposals for income from transactions of NFP entities on the IFRS 15 revenue recognition model. Staff consider that the economic substance of contingently refundable donation components that would fail the 'revenue constraint' is significantly different from the economic substance of donation components that are not contingently refundable—this supports the different treatment that the 'revenue constraint' would require. The latter types of donation component do not require the entity to transfer any goods or services to the customer in order to retain the donation. Staff also think it should be borne in mind that the 'revenue constraint' would often be passed by NFP entities in relation to their contingently refundable donation components, because those entities will often have a strong degree of control over whether the promised goods or services will be transferred to the customer.

41 Staff think that contingently refundable donation components are likely to be much more pervasive for NFP entities than for-profit entities (in the context of applying paragraph 12 of the Board's *Process for Modifying IFRSs for PBE/NFP*, which also refers to whether modifications to the relevant IFRS are warranted to ensure user needs are met while considering the balance between costs and benefits). However, staff do not think it would help meet user needs to apply the 'revenue constraint' in paragraphs 56 and 57 of IFRS 15 to variable consideration related to promises to transfer goods or services, and not to also apply that revenue constraint to contingently refundable donation components. For these reasons, AASB staff recommend that NFP entities should apply the 'revenue constraint' in paragraphs 56 and 57 of IFRS 15 when determining when to recognise revenue in relation to contingently refundable donation components of contracts with customers.

Questions for Board members

Q5 Do you agree with the AASB staff recommendation that NFP entities should apply the 'revenue constraint' in paragraphs 56 and 57 of IFRS 15 when determining when to recognise revenue in relation to contingently refundable donation components of contracts with customers (see paragraphs 41 – 42 above)?

Q6 If you disagree with the outcome of applying the 'revenue constraint' in paragraphs 56 and 57 of IFRS 15, which treatment would you prefer, and why?

Possible exemptions from separate recognition of donation components of contracts with customers for cost-benefit reasons

Contracts in which performance obligations are incurred and extinguished during the same period

42 One possible approach for limiting the cost of separately identifying, and accounting for, donation components of contracts with customers would be to exempt an entity from having to do so if the donation is received (or becomes receivable) and the promised goods or services are transferred during the same period. The rationale for such an exemption would be that it would limit the cost of accounting for contracts with customers without affecting the amount of income recognised by the entity during the period or the amount of the entity's liabilities recognised at the end of the period.

43 AASB staff think it should be borne in mind that dissecting contract income between revenue from transferring goods and services to customers and donations would provide useful information about the extent to which the entity is dependent on donations to recover its expenses. Revenue from transferring goods and services to customers and donations might differ in predictability and persistence. In addition, AASB staff note that providing the exemption described in paragraph 43 above would be unlikely to foster consistency in how donations are accounted for. This is because the exemption would affect some donation components in contracts with customers, but would not affect contracts/transactions wholly composed of donations. Thus, providing the exemption would mean that how donations are accounted for would depend, in part, on whether they are components of contracts giving rise to performance obligations or occur in contracts/transactions giving rise to no performance obligations. A general aim in IFRSs (and thus Australian Accounting Standards) is that the accounting for a particular economic phenomenon should not depend on how that phenomenon is bundled or unbundled.

44 AASB staff think the arguments in paragraph 44 against providing the exemption are more persuasive than the reason for the exemption set out in paragraph 43, and therefore recommend not proposing in the ED to provide that exemption.

Question for Board members

Q7 Do you agree with the AASB staff recommendation not to exempt an entity from accounting separately for a donation component if the donation is received (or becomes receivable) and the promised goods or services are transferred during the same period (see paragraph 45 above)?

Application of materiality

44 In relation to whether a contract with a customer includes a financing component that is significant and therefore needs to be accounted for as a separate component of the contract, paragraph BC234 of the Basis for Conclusions on IFRS 15 states that:

> "During their redeliberations, the boards clarified that an entity should consider only the significance of a financing component at a contract level rather than consider whether the financing is material at a portfolio level. The boards decided that it would have been unduly burdensome to require an entity to account for a financing component if the effects of the financing component were not material to the individual contract, but the combined effects for a portfolio of similar contracts were material to the entity as a whole."

45 AASB staff recommend that an assessment of whether a donation component of a NFP entity's contract with a customer is material should be made at a contract level, and should not need to be reassessed at another unit of account, such as for a portfolio of similar contracts. Such a treatment would:

(a) be consistent with IFRS 15 regarding the circumstances in which any financing component of a contract with a customer should be required to be accounted for separately; and

(b) would be likely to achieve a better balance of costs and benefits than if the materiality of donation components of a NFP entity's contracts with customers were to be assessed at a portfolio level for similar contracts.

46 For similar reasons, AASB staff recommend that, for any transaction wholly composed of a donation in the form of non-cash consideration, an assessment of whether the donation is material should be made at a transaction level, and should not need to be reassessed at another unit of account, such as for a portfolio of similar transactions. For example, if a charity receives multiple donations of used clothing, it would be unlikely that any donation would be individually material. Collectively, all of the donations of clothing might be material. However, measuring the fair value of such donated assets would be difficult and burdensome (as compared with donations in the form of cash consideration), and the resulting costs would be unlikely to be exceeded by the benefits to users of financial statements (i.e. the revenue from such donations would be recognised when the items of clothing are sold, except if the entity were to elect to recognise the donated clothing upon receipt). Therefore, the materiality of the donations of clothing should not be required to be reassessed at a 'portfolio' level.

Questions for Board members

Q8 Do you agree with the AASB staff recommendation that whether a donation component of a NFP entity's contract with a customer is material should be assessed at a contract level, and should not need to be reassessed at another unit of account, such as for a portfolio of similar contracts (see paragraph 48 above)?

Q9 Do you agree with the AASB staff recommendation that, for any transaction wholly composed of a donation in the form of non-cash consideration, an assessment of whether the donation is material should be made at a transaction level, and should not need to be reassessed at another unit of account, such as for a portfolio of similar transactions (see paragraph 49 above)?

Appendix A

Extracts from IFRS 15 *Revenue from Contracts with Customers*

"77 The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service.

78 If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

79 Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

(a) Adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.

(b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

(c) Residual approach—an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 78, the stand-alone selling price of a good or service only if one of the following criteria is met:

(i) the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or

(ii) the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

80 A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, an entity may use a residual approach to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices and then use another method to estimate the stand-alone selling prices of the individual goods or services relative to that estimated aggregate stand-alone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the stand-alone selling price of each promised good or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective in paragraph 73 and the requirements for estimating stand-alone selling prices in paragraph 78."

Appendix B

Extracts from IPSAS 29 *Financial Instruments: Recognition and Measurement* regarding 'Concessionary Loans'

Application Guidance

"AG84 Concessionary loans are granted to or received by an entity at below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education and housing loans granted to low income families. Entities may receive concessionary loans, for example, from development agencies and other government entities.

…

AG87 As concessionary loans are granted or received at below market terms, the transaction price on initial recognition of the loan may not be its fair value. At initial recognition, an entity therefore analyzes the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG88 and AG89 below.

AG88 An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a grant, a contribution from owners or a combination thereof, by applying the principles in IPSAS 28[6] and paragraphs 42–58 of IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in paragraphs AG101–AG115. Where an entity cannot determine fair value by reference to an active market, it uses a valuation technique. Fair value using a valuation technique could be determined by discounting all future cash receipts using a market related rate of interest for a similar loan (see AG82)."

6 *Financial Instruments: Presentation*