Topic 16L: Presentation of Financial Statement Disclosures – Deferred Revenue Disclosure

Discussion

What footnote format is the most useful to lenders and other financial statement readers for disclosing information about a not-for-profit organization's deferred revenue?

GAAP Requirement

Deferred revenue (also known as unearned revenue) can arise from several types of transactions, including:

- Deposits received on real estate sales which are insufficient to fully recognize a sale under GAAP (e.g. less than 10% for multi-family residential property, or 20-25% for undeveloped land) resulting in use of the cost-recovery method, the installment method, the reduced profit method, or percentage-of-completion method,
- Fees or grants for services received prior to completion of the earnings process,
- Rents received prior to the period earned. and
- Deferred developer fees.

Disclosures required by GAAP mostly relate to the first category above. Organizations should also disclose their accounting policy regarding revenue recognition, which is usually done in the summary of significant accounting policies note.

GAAP does not specify required disclosures for the other types of deferred revenue.

Analysis/Input

Deferred revenue can be grouped with another type of liability if immaterial, however readers should evaluate deferred revenue differently than other types of liabilities. Deferred revenue represents revenue to be earned in a future period whereas other types of liabilities involve obligations to pay out cash.

Real Estate Sales

The first category of deferred revenue listed above is rarely encountered by affordable housing developers, although it would be significant for single-family home developers. Although real estate sales may occur among controlled entities, such sales and any deferred revenue thereon would be eliminated in consolidation.

A deferred gain on sale might arise from the sale of real property to an entity that is not under common control, but that would be unusual for an affordable housing developer since most real estate sales occur between affiliated members of the controlled group of organizations. As such, no gain will be recognized or deferred since assets and liabilities are transferred at net book value.

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Fees or Grants for Services Received in Advance

The second category is most commonly encountered when government or foundation grants are received in advance of performing the activities necessary to earn the grants. Governmental funding is often released after qualified expenses are incurred. Other grants that are funded in advance may be contribution-type awards, which do not result in deferred revenue. Such contributions are treated as restricted until qualifying expenses are incurred. See Strength Matters Financial Reporting Best Practices Paper Topic 21: *Accounting for Contributions, Exchange Transactions and Forgivable Loans* for more guidance on distinguishing a contribution-type grant from an exchange transaction. Many government grant programs require repayment of funding if conditions for earning the grants are not met. If there is a greater-than-remote chance that such conditions will not be met, recognition of the revenue should be deferred until the conditions are met. The grant agreement may allow a portion of the revenue to be considered earned ratably over the compliance period.

Rents Received in Advance

The third category arises often, since residents frequently pay their rent before the first day of the month, although the amounts are generally immaterial to the consolidated group. More significant unearned rent may be received pursuant to a ground lease when development budgets have cash available to fund a sizeable deposit towards the ground lease, relieving some of the obligation to fund the ground lease from future operational cash flows. However, this transaction would usually be eliminated through consolidation since the unearned rent liability for one consolidated entity offsets the prepaid rent asset recognized by another.

Deferred Developer Fees

The final category, deferred developer fee, is another example of a fee received prior to completion of the earnings process. Developers often adopt an accounting policy which delays recognition of the final 5-15% of the developer fee until all milestones for earning the fee have been met. For example, a limited partnership would normally recognize 100% of the developer fee as part of depreciable basis in the year that the property is placed in service, since doing so allows the partnership to take tax credits on the eligible basis for that year. The partnership's developer fee payable will normally equal the receivable recognized by the developer. However, the developer may need to perform additional work subsequent to year-end in order to obtain a cost certification audit and Form 8609 which are milestones necessary to complete the earnings process. In this example, a deferred developer fee liability would be recorded for the unearned portion of the fee.

Another situation which would create a deferred developer fee is receipt of a pre-payment towards a developer fee prior to earning it. This might occur if adequate development sources were available to prepay the fee.

A third example of a deferred developer arises when developers consolidate their financial statements with affiliates who have paid and capitalized the fees. In such cases, developers often defer recognizing the profit portion of the developer fee. This deferred developer fee profit actually represents an adjustment to the subsidiaries' fixed asset balances, so this credit often appears as a reduction of property and equipment rather than as deferred revenue. See Strength Matters Paper 4b *Developer Fee Elimination During Consolidation or Combination* for more information on this topic.

Readers should be aware that revenue recognition rules will change in a few years (2019 for nonpublic companies). The new revenue recognition rules continue to allow a developer to recognize fees over time prior to completion of a performance obligation, since the developer creates or enhances an asset that the partnership controls as the asset is created or enhanced. Therefore, deferred developer fees will continue to be recognized under the new rules.

Sample Financial Statement Disclosures

As is the case with most financial statement disclosures, materiality of the account balance should be considered when determining the amount of detail to provide in the disclosure. Disclosures need not repeat information that is included in the basic financial statements, however disclosures required by GAAP will not be satisfied by including the information in the supplementary information section of the financial statements.

NOTE X – DEFERRED REVENUE

Deferred revenue of ABC and Affiliates consisted of the following at December 31, 2015 and 2014

	2015	2014
Unearned grant revenue	$ 10,000,000	$ 10,000,000
Unearned rent	57,000	32,000
Total	$ 10,057,000	$ 10,032,000
Deferred revenue eliminated in consolidation:		
Deferred developer fees	$ 200,000	$ 350,000

Unearned Grant Revenue

ABC Developer received grant proceeds of $10 million in 2009 from the City of San Francisco which is to be used to develop affordable housing within San Francisco subject to certain conditions described in the grant agreement which expire in the year 2020. Due to the uncertainty of meeting these conditions, ABC defers recognition of the $10 million until all conditions will be met in 2020.

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Unearned Rent

Unearned rent arises from receipt of rental income prior to the period earned. Residential rents are due on the first of each month but tenants occasionally pay rent a few days in advance. Subsidy income may also be received prior to the month earned.

Deferred Developer Fees

ABC Developer earns developer fees from consolidated affiliates. These inter-company fees are eliminated in consolidation. The balance in ABC Developer's deferred developer fees represents 5% of developer fee income which is deferred pending completion of the final services required under the development services agreement.

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