MaherDuessel

Pursuing the profession while promoting the public good©

www.md-cpas.com

Contributions and Revenue Recognition

Contributions

ASU 2018-08, *"Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (Topic 958)"*

- Effective for periods beginning after December 15, 2018 (12/31/19 and 6/30/20 year ends)
- This amendment provides guidance for characterizing grants and similar contracts with government agencies and others as reciprocal transactions (exchanges) or nonreciprocal transactions (contributions) and distinguishing between conditional and unconditional contributions.

Contribution Definition

An unconditional transfer of cash or other assets (including a promise) to an entity in a voluntary non-reciprocal transfer.

Who Must Follow AUS 2018-08?

- All NFPs
- Some business entities
- Entities receiving contributions no matter what they are called
  - Gifts
  - Grants
  - Donations

Exchange Transaction vs Contribution

- Considerations to be Made:
  - A benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider
  - Execution of the resource provider’s mission shall not constitute commensurate value received
  - Expressed intent by both parties to exchange resources
  - If the resource provider has full discretion in determining the amount of the transferred assets, the transaction is indicative of a contribution
  - If the penalties for nonperformance exceed the amount of assets transferred, the transaction is indicative of an exchange

Exchange Transaction vs Contribution

- The following are *not* contributions:
  - Transfers of assets that are in substance purchases of goods or services
  - Transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary
  - Tax exemptions, tax incentives, or tax abatements
  - Transfers of assets from government entities to business entities
  - Transfers of assets that are part of an existing exchange transaction between a recipient and an identified customer
    - Example: Medicare, Medicaid

Exchange Transaction vs Contribution

- For contributions, an entity should follow guidance in Subtopic 958-605
- For exchange transactions, an entity should follow other guidance (for example, Topic 606, *Revenue from Contracts with Customers*)

Conditional vs Unconditional Contributions

- Donor-imposed condition must have both:
  - **A right of return to the contributor for assets transferred** (or for a reduction, settlement, or cancellation of liabilities) or a right of release of the promisor from its obligation to transfer assets (or reduce, settle, or cancel liabilities)
  - **One or more barriers** that must be overcome before a recipient is entitled to the assets transferred or promised

Indicators to Determine a Barrier

To determine what is a barrier, an NFP would consider indicators, which would include, but are not limited to, the following:

Measurable Performance-Related Barrier or Other Measurable Barrier. The agreement includes a measurable performance-related barrier or other measurable barrier. Measurable performance-related barriers or other measurable barriers often are coupled with a time limitation. Examples of barriers could include: indicating that the outcomes are to be achieved within a specified time frame, specific outputs, outcomes, outside events.

Related to the Primary Purpose of the Agreement. The barriers are related to the primary purpose of the agreement. This excludes administrative tasks and trivial stipulations i.e. monthly fiscal reports

Limited Discretion by the Recipient. The recipient has limited discretion over how the transferred assets should be spent. Limited discretion excludes situations in which the only requirement by the resource provider is that the transferred assets be spent for general operating purposes, which could include amounts restricted for ongoing programs or activities. If a recipient has broad discretion on how to use the funds and the agreement contains no stipulations that would indicate a barrier exists, the agreement shall be deemed unconditional. qualifying costs of federal funds

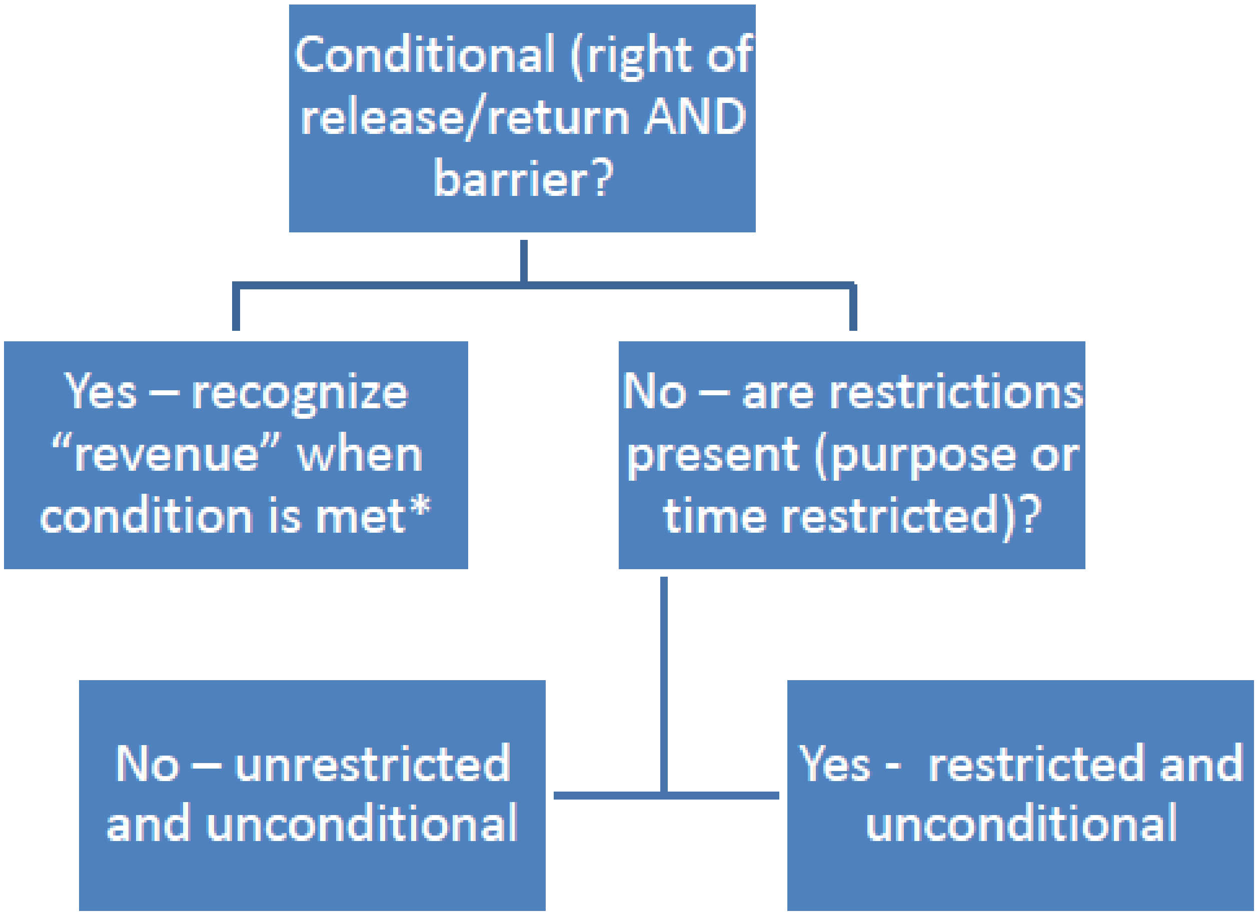
Additional Actions. The recipient shall undertake the additional identified actions (for either a new or existing stipulation) it otherwise would not have taken to be entitled to the transferred assets for the funds to be spent. If a resource provider's stipulation results in a recipient's requirement to undertake additional actions, endeavors, or goals along with the activities that the recipient intends to pursue, the stipulation would be more indicative of a conditional contribution because the barrier that must be overcome for entitlement to the funds would be the establishment of the increased activity to meet the resource provider's stipulation.

Examples: Measurable Barriers vs. "Best Efforts" Metrics

- Two examples in the Codification:
  - Both grants that contain right of return/release for funds not spent on the program
- Measurable Barriers (accounted for as **conditional**):
  - Foundation grant for career training to disabled veterans
  - A specified level of service (with specific minimum targets that must be met) is a barrier on which entitlement depends
  - The likelihood of serving those minimums is not considered
- "Best Efforts" Metrics (account for as **unconditional**):
  - Foundation grant for a recreational organization's tennis program
  - Consistent with grant proposal, contains guidelines, with metrics, about how to use funds towards the program
  - However, entitlement is not dependent upon meeting those guidelines, as long as the funds are used toward the program.

  Note: Barriers exclude trivial and administrative stipulations

Determining if Conditions Exist



Contributions Received

- Contributions received shall be recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received.
- The classification of contributions received as revenues or gains depends on whether the transactions are part of the NFP's ongoing major or central activities (revenues), or are peripheral or incidental to the NFP (gains).
- A contribution made and a corresponding contribution received generally are recognized by both the donor and the receiver at the same time, that is, when made or received, respectively. If conditional, the contribution is recognized when the barrier is overcome.
- After a contribution has been deemed not to contain a donor-imposed condition, an entity shall consider whether the contribution includes a donor-imposed restriction, which includes the consideration about how broad or narrow the purpose of the agreement is and whether the resources can be used only after a specified date.

Implementing ASU 2018-08

- Should be applied on a modified prospective basis
  - In the first set of financial statements following the effective date, the amendments should be applied to agreements that are either:
    - Not completed as of the effective date
    - Entered into after the effective date
- Retrospective application is permitted

Implementing ASU 2018-08

- Modified Prospective Basis:
  - A completed agreement is an agreement for which all the revenue (of a recipient) or expense (of a resource provider) has been recognized before the effective date in accordance with current guidance.
  - No prior results should be restated, and there should be no cumulative-effect adjustment to the opening balance of net assets or retained earnings at the beginning of the year of adoption.
  - Required to disclose:
    - The nature of and reason for the accounting change
    - An explanation of the reasons for significant changes in each financial statement line item in the current annual or interim period resulting from applying the amendments instead of the previous guidance.

Contribution Disclosures

- No additional recurring disclosures have been added in the guidance
- Guidance includes disclosures for unconditional and conditional promises to give
- For conditional promises to give, recipients are required to disclose:
  - The total of the amounts promised
  - A description and amount for each group of promises having similar characteristics

Contribution Disclosures

- Not intended to be a laundry list disclosure
- Consider key attributes of the barriers such as:
  - Subject to matching
  - Incurring qualifying expenses
  - Measurable performance barrier

Revenue Recognition

Revenue Definition

Transfer of promised goods and services to a customer in an amount that reflects the consideration to which the entity expects to be entitled

ASU 2014-09, *"Revenue from Contracts with Customers (Topic 606)"*

- Effective for periods beginning after December 15, 2018 (12/31/19 and 6/30/20 year ends)
- This amendment provides guidance for revenue recognition related to contracts with transfer of promised goods or services to customers and related disclosures.

Not Included in Topic 606

- Lease contracts
- Insurance contracts
- Financial instruments
- Guarantees
- Nonmonetary exchanges in the same line of business to facilitate sales to customers
- Contributions
- Collaborative arrangements

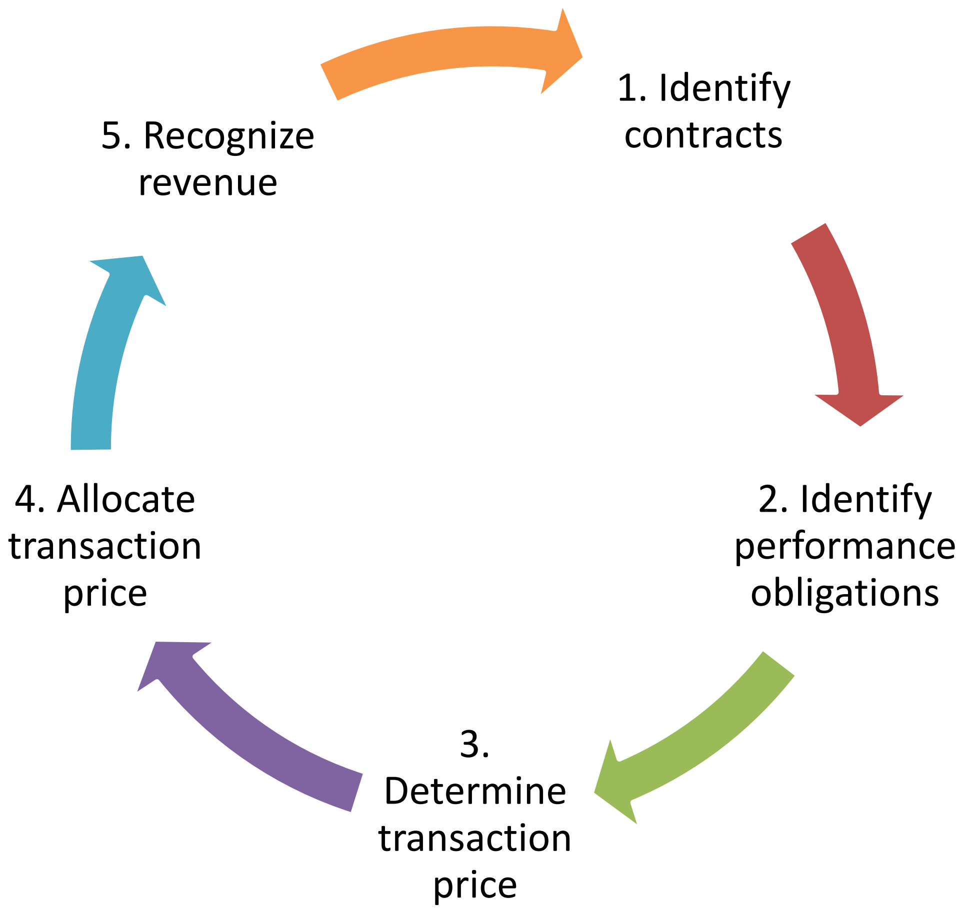
Topic 606 NFP Areas of Focus

- Membership dues
- Subscriptions
- Tuition
- Fees for service
- Retail sales
- Licensing
- Potentially some government grants and contracts

How the New Revenue Recognition Standard Works

- The standard adds a degree of complexity to the revenue recognition process.
- Instead of revenue simply being recognized when earned or as the earning process is completed, revenue is recognized *after certain steps or hurdles have been cleared*.
- This means that we will be looking at revenue transactions more thoughtfully and from more angles than perhaps done historically.

Steps to Apply Revenue Recognition



Step 1: Identifying the Contract with a Customer

- When the new revenue recognition standard refers to a **contract** with a customer, it does not have to be a written contract.
- A contract may be oral or even implied by the entity's customary business practices, but it needs to create rights and obligations that are legally enforceable against the parties.

When a Contract Does Not Exist

- A contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties) ***or*** the collectability threshold is not met.
  - A contract is wholly unperformed if the entity has not yet transferred any promised goods or services to the customer and the entity has not yet received, ***and*** is not yet entitled to receive, any consideration in exchange for the promised goods or services.
  - To meet the collectability threshold, an entity must conclude that it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.
- Note: Determining whether a contract is *wholly unperformed* and whether *collectability threshold* has been met will be a bigger challenge for some NFPs (e.g. universities with tuition and housing revenues) than others.

Contract with a Customer

- An entity shall account for a contract with a customer that is within the scope of Topic 606 only when all of the following criteria are met:
  - The parties to the contract have approved the contract and are committed to perform their obligations
  - The entity can identify each party’s rights
  - The entity can identify the payment terms
  - The contract has commercial substance
  - It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer

Example of Step 1:

- Zoo X offers memberships to its supporters. The annual memberships go for $250 each. Zoo X has determined that $100 of this amount is a contribution and that $150 is an exchange transaction for benefits that members receive.
- In applying the 1st step, Zoo X will likely conclude that the $100 portion of the membership that is a contribution is not subject to the new revenue recognition standard and the $150 portion of the membership that is an exchange transaction (i.e. a contract) is subject to the new revenue recognition standard.

Exercise for Step 1: When do I have a contract?

- Trade Association X believes that all of its annual membership dues are exchange transaction revenue. Trade Association X has a 9/30 year end and bills its members for the upcoming year (i.e., 10/1 to 9/30) around 7/31 each year.
- Under the new revenue recognition standard, do you believe Trade Association X would say it has a contract with the customer on:
  - 7/31 when it bills the customer; OR
  - When it actually receives the renewal payment

Solution to Exercise for Step 1

- Under the new revenue recognition standard, Trade Association X would most likely say that it has a contract when it actually receives the renewal payment as until it occurs, rights and obligations do not exist between the parties as the member has not accepted the "contract".
- Note: *Some* NFPs today try to record deferred revenues and accounts receivable for billed amounts instead of billed and received amounts if they believe that they will actually receive these amounts shortly after year end. Under the new revenue recognition standard, this position will be much more difficult to take as a contract is not in place just based on the billing.

Step 2: Identifying the Performance Obligations in the Contract

- A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer.
- At the inception of a contract, the entity will assess the goods or services promised to be transferred to the customer and identify as a performance obligation (possibly multiple performance obligations) each promise to transfer the customer either:
  - A good or service, or a bundle of goods or services that is distinct; OR
  - A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
- A good or service that is not distinct will be combined with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some situations, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Example of Step 2:

- The annual memberships at Zoo X go for $250 each. Zoo X has determined that $100 of this amount is a contribution and that the remaining $150 is a contract for the benefits that members receive (i.e. the performance obligations).
- In step 2, Zoo X will identify the specific performance obligations and their characteristics. For example, Zoo X determines that the benefits provided consist of:
  – An annual pass to Zoo X
  – A monthly newsletter
  – Attendance at the annual Zoofest Gala

Step 3: Determining the Transaction Price

- The transaction price is the amount of consideration (fixed or variable) that the entity expects to be entitled to in exchange for transferring the promised goods or services to the customer.
- An entity should consider the terms of the contract and its customary business practices in determining the transaction price.

Example of Step 3:

- Zoo X determines that the benefits provided (i.e. the annual pass to Zoo X, the monthly newsletter, and the attendance at the annual Zoofest Gala) are valued at $150.

Step 4: Allocating the Transaction Price to the Performance Obligations in the Contract

- The transaction price is allocated to separate performance obligations in proportion to the stand-alone selling price of the promised goods or services.
- When a contract has only one performance obligation, the entire transaction price is attributed to that performance obligation.
- If the contract has more than one performance obligation, the transaction price will be allocated among the individual performance obligations. That allocation is done based on the stand-alone selling prices of each of the distinct goods or services underlying the performance obligations. Note: An entity should estimate a stand-alone selling price if it is not directly observable.

Example of Step 4:

- Zoo X determines that the $150 exchange transaction (i.e. contract) components of the membership consist of:
  – An annual pass to Zoo X valued at $50
  – A monthly newsletter valued at $25
  – Attendance at the annual Zoofest Gala valued at $75

Step 5: Recognizing Revenue When (or as) Each Performance Obligation is Satisfied

- The 5th step in the new recognition standard is to recognize revenue
- The revenue recognized when the transfer of the promised good or service to a customer is equal to the amount allocated to the satisfied performance obligation, which may be satisfied at a point in time or over time.
- A good or service is transferred when (or as) the customer obtains control of that good or service.

Example of Step 5:

- In the example of Zoo X, the annual pass to the zoo and monthly newsletter would likely be recognized as revenue over the 12 months and the amount allocated to the annual Zoofest Gala would likely be recognized after the event.

Exercise for Step 5: When do I recognize this?

- The Today and Tomorrow Theatre offers lifetime subscriptions to all future theatrical productions for $2,000. The subscriptions are non-refundable and non-transferable. The Today and Tomorrow Theatre believes the subscriptions are entirely exchange in nature.
- Over what time period would you suggest the lifetime subscription revenue be recognized under the new revenue recognition standard?

Solution to Exercise for Step 5

- The Today and Tomorrow Theatre would likely consider recognizing revenue over the average time span of the subscription, the life expectancy of the subscriber, or other suitable time periods.

Significant Disclosure Requirements

- There are significant disclosures requirements in Topic 606. An entity will disclose qualitative and quantitative information about:
  - Contracts with customers (including revenue recognized, disaggregation of revenue, and information about contract balances and performance obligations); AND
  - Significant judgements and changes in judgements affecting the amount of revenue and assets recognized (determining the timing of satisfaction of performance obligations and determining the transaction price and amounts allocated to performance obligations).

AICPA Resources

- The AICPA has developed an Audit and Accounting Guide entitled *Revenue Recognition*. This document provides nonauthoritative accounting guidance related to ASU No. 2014-19 and subsequent ASUs amending FASB ASC 606. The 2018 version of the document contained guidance related to:
  - Tuition and housing revenues for universities
  - The bifurcation of transactions between contributions and exchange components
  - Subscriptions and membership dues
  - Health care entities

Resources

AICPA

- Not-for-Profit Accounting and Auditing Guide
- Not-for-Profit Section of AICPA.Org.

FASB

- Educational Resources (Revenue)
- FASB in FOCUS (Newsletter and video)

Questions? Contact Me!

Contact the manager on your engagement.