

FASB Exposure Draft and Changes to Nonprofit Revenue Recognition (Topic 958-605)

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Speaker Introductions

- **Michael Johns**

Michael is a principal at CLA with over 17 years of experience in public accounting. Michael specializes in providing assurance and audit services for a nonprofit organizations. In addition to assisting clients with technical accounting and reporting issues, he has extensive experience developing audit plans. His work includes the performance of internal control reviews, reliability of financial reporting, compliance with applicable laws and regulations, and compliance audits in accordance with the Uniform Guidance.

- **Megan Terrell**

Megan is a principal with CLA with a passion for serving nonprofit organizations. She specializes in providing consulting and assurance services to nonprofits of all sizes and structures, ranging from very small organizations to those with multi millions in assets and revenue. An active speaker, Megan regularly engages with the nonprofit community to provide guidance on financial and governance topics.



Learning Objectives

At the end of this session, you will be able to:

- Distinguish between contribution and exchange transactions and the applicable revenue standard
- Distinguish between conditional and unconditional contributions and grants
- Discuss timing of contribution and grant revenue recognition



Scope

- Applies to **all entities** (NFPs and business entities) that receive or make contributions, unless otherwise indicated
- Excludes transfer of assets from the government to business entities
- Applies to both contributions received by a recipient and contributions made by a resource provider



Why the Change?

Project added to FASB's Technical agenda

- **Improve** existing guidance
- **Clarify** existing guidance

ASU 2014-09, *Revenue from Contracts with Customers*, including related disclosures, heightened the issue

- Raised question as to whether grants and contracts are in the scope of that guidance
 - Reciprocal?
 - Nonreciprocal?

Long-standing diversity in practice classifying grants and contracts, particularly from governmental entities

- Reciprocal vs. Nonreciprocal
- Conditional vs. Unconditional



Issue 1: Grants and Contracts: Reciprocal vs Nonreciprocal

- Many NFPs treat federal grants/contracts with governmental entities as exchanges (regardless of substance)
- Some equate the government with general public
 - Issue is whether government receives direct commensurate value in return (because the public benefits)
- Many believe the government doesn't give "contributions"



Issue 2: Conditional vs Unconditional Contributions

- Stakeholders find it difficult to distinguish between a conditional and unconditional contributions
 - Leads to diversity in application
- If funds are provided with certain stipulations, there's difficulty in distinguishing whether contribution is conditional, restricted, or both
- Diversity in application of “remote” notion
 - Whether likelihood of failing to meet a condition is remote
 - ◇ Some NFPs believe any condition within their control has remote likelihood of not being met



Issue 1: Who Receives the Benefit?

Current
Practice

Proposed
Clarification

Exchange

Exchange

Follow Topic 606 (or
other, such as Leases)

Nonexchange

Follow Topic 958-605

Direct
commensurate
value to
resource
provider

Specified third
parties

General public

Direct
commensurate
value to
resource
provider

Specified third
parties
Government/
resource
provider is a
3rd party payer
on behalf of an
identified
customer*

Specified third
parties
Continue to
monitor GASB
and IPSASB
projects in this
area**

General public

*The revenue recognized would actually be the underlying contract's patient service revenue, tuition revenue, etc.

**A focus on whether or not there is a "performance obligation" could even ultimately include some contracts where the general public is the primary beneficiary



Reciprocal vs Nonreciprocal – Key Clarifications

- Resource provider is NOT synonymous with the general public
 - Includes governmental entities and private foundations
 - If a resource provider receives value indirectly by providing a societal benefit, this would be considered a nonreciprocal transaction
- If the primary beneficiary of a grant or contract is a 3rd party, an NFP must use judgment to determine if the transaction is reciprocal or nonreciprocal



Reciprocal vs Nonreciprocal – Key Clarifications

- Furthering a resource provider's mission or positive sentiment from acting as a donor does not constitute commensurate value received
- The type of resource provider should not override the substance of the transaction



Example: Grant from Federal Government – Reciprocal or Nonreciprocal?

- University D is awarded a grant from the federal government
- The agreement requires University D to:
 - Follow the rules and regulations established by the OMB
 - Incur certain expenses (or costs) in compliance with rules and regulations established by the OMB and federal awarding agency
 - Obtain an annual audit in accordance with OMB guidelines
 - Submit a summary of research findings to the federal government
- Any unused assets are forfeited and any unallowed costs that have been drawn down by University D are required to be refunded
- University D retains the rights to the findings



Conclusion

- University D concludes this is a nonexchange (nonreciprocal) transaction
 - Commensurate value is not being exchanged between the two parties
 - University D retains all rights to the research and findings received and the primary benefit of the findings
 - The federal government's benefit is considered indirect because the research and findings serve the general public



Example: Resources to Fund Clinical Trial – Reciprocal or Nonreciprocal?

- University A receives funds from a pharmaceutical entity to finance the costs of a clinical trial for a drug developed by the pharmaceutical entity
- The pharmaceutical entity specifies the protocol for testing
 - Number of participants tested
 - Dosages administered
 - Frequency and nature of follow up exams
- The pharmaceutical entity requires a detailed report of the outcome within two months of conclusion of the trial



Conclusion

- University A concludes this is an exchange (reciprocal) transaction
 - Commensurate value is being received by the pharmaceutical entity
 - ◇ Results of the trial have particular commercial value to the pharmaceutical entity
- The disbursement of the funds is also NOT treated as a contribution made by the pharmaceutical entity



Issue 2: Conditional vs Unconditional

For a *donor-imposed* condition to exist it must have BOTH:

- A right of return or release
- A barrier
 - ◇ Proposed ASU includes indicators and examples to assist in determination



Indicators to Determine a Barrier

The inclusion of measurable performance-related barrier or other measurable barrier

Whether a stipulation is related to the purpose of the agreement

The extent to which a stipulation limits discretion by the recipient

The extent to which a stipulation requires an additional action or actions.



When is Revenue Recognized?

- When no longer conditional
 - No longer a right of return or release
 - No longer a barrier
- Funds received in advance would be recorded as a liability in the recipient's books
- Contributions made should generally be recognized by the donor at the same time the donee recognizes the contribution received
 - Donor does not recognize until the contribution has become unconditional
 - Follows same determination criteria as donee



Example: Grant from Federal Government – Conditional or Unconditional

- University D is awarded a grant from the federal government
- The agreement requires University D to:
 - Follow the rules and regulations established by the OMB
 - Incur certain expenses (or costs) in compliance with rules and regulations established by the OMB and federal awarding agency
 - Obtain an annual audit in accordance with OMB guidelines
 - Submit a summary of research findings to the federal government
- Any unused assets are forfeited and any unallowed costs that have been drawn down by University D are required to be refunded
- University D retains the rights to the findings



Conclusion

- University D concludes the grant is conditional
 - The grant agreement limits the University's discretion as a result of the specific requirements regarding how funds may be spent (qualifying expenses)
 - There is a right of return and release
 - The audit requirement alone is not a barrier to entitlement as it is not related to the purpose of the grant



Example: Contribution to a University – Conditional or Unconditional?

- University G is conducting a capital campaign to:
 - Build a new building to house its school of mathematics
 - Make capital improvements to existing buildings on campus
- University G receives an upfront grant in the amount of \$10k from a private foundation in response to a proposal submitted as part of its capital campaign
- Agreement contain a right of return of the assets to the resource provider if the assets are not used for the purpose outlined in the solicitation materials
- Resource provider does not include any specifications regarding how the building should be constructed or how improvements should be made



Conclusion

- University G concludes the grant is unconditional
 - It has broad discretion over how the transferred assets should be used
 - ◇ Can be used toward the new building or toward other capital improvements
 - Resource provider does not include any specifications regarding how the building should be constructed or how improvements should be made
 - ◇ Agreement only indicates funds must be used for purposes outlined in the solicitation materials
- Grant is donor-restricted



Example: Contribution for a New Wing – Conditional or Unconditional?

- NFP I plans to build a new wing on a existing building
- NFP I receives a solicited multi-year grant in the amount of \$1 million from an individual to be used for the new wing
- Agreement includes specific building requirements
 - Specified square footage
 - Environmentally friendly LEED certified
- First installment received after NFP I submits architectural designs that meet specifications
- Additional installments paid in intervals as specific requirements within the agreement are met
- If the building is not built according to specifications, the donor is released from its obligation



Conclusion

- NFP I concludes the grant is conditional
 - Includes measurable performance related barriers to overcome
 - ◇ Architectural plan including square footage and LEED certification
 - Resource provider is released from obligation to transfer assets if stipulations are not met
- Revenue is recognized as the barriers are overcome
 - The meeting of specifications throughout the build
- Donor records contribution expense as NFP I overcomes barriers



Example: Contribution for Expansion—Conditional or Unconditional?

- NFP F receives an unsolicited 2 year grant in the amount of \$500,000 from a private foundation to be used to expand its operations
- Funds were given up front
- NFP F must expand its facility by 5,000 square feet by the end of 2 years
- Grant contains a right of return for any unused assets

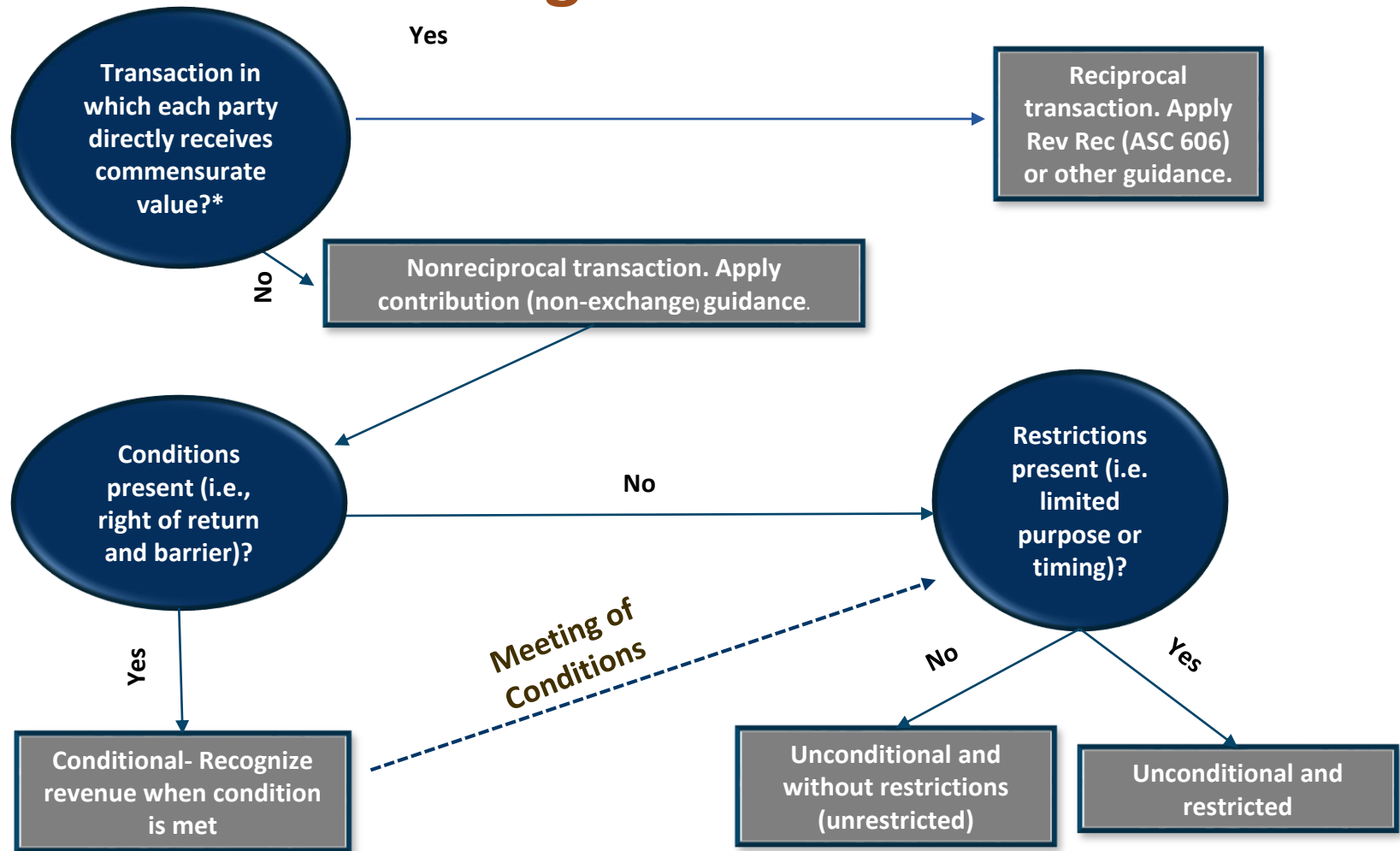


Conclusion

- NFP F concludes the grant is conditional
 - Includes measurable barrier to overcome
 - ◇ 5,000 additional square feet
 - Right of return for unused assets or unmet requirements
 - Meets additional actions indicator
 - ◇ Grant was unsolicited and would require NFP F to take action it would not have taken
- Revenue is recognized when the barriers are overcome and right of return no longer exists
 - Funds recorded as a liability until recognized
- Donor records contribution expense when NFP F has overcome barriers and right of return no longer exists

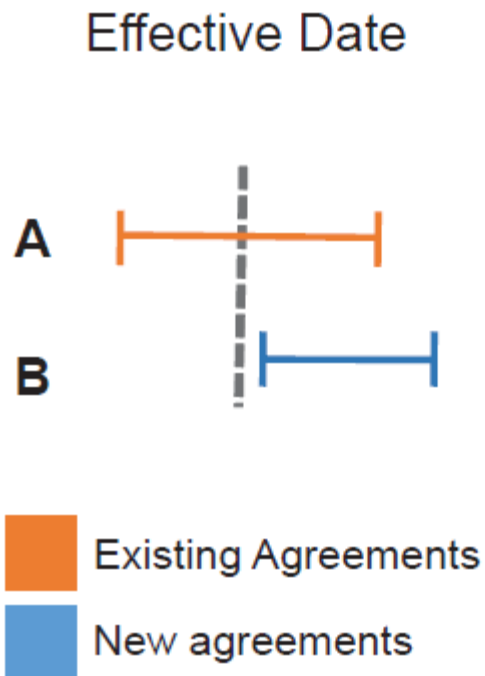


NFP Revenue Recognition Decision Process



*Includes third-party payments on behalf of identified customers. These do not create new revenue.

Transition Approach



- **Modified Prospective**
 - Apply to all agreements:
 - Existing at the effective date (only apply to the portion of existing agreements not previously recognized)
 - Entered into after the effective date
- **No restatement of prior amounts recognized**
- **Retrospective Application Permitted**

Effective Date

Same as New Rev Rec Standard
(early adoption is permitted)

Annual periods beginning after December 15, 2017,
including interim periods

Annual periods beginning
after December 15, 2018,
and interim periods
beginning after December
15, 2019

Public Business Entities

NFP that has issued, or is a
conduit debt obligor for,
securities that are traded,
listed, or quoted on exchange
or an over-the-counter market

All other entities



Project Timeline



Call to Action! FASB Wants to Hear from YOU!



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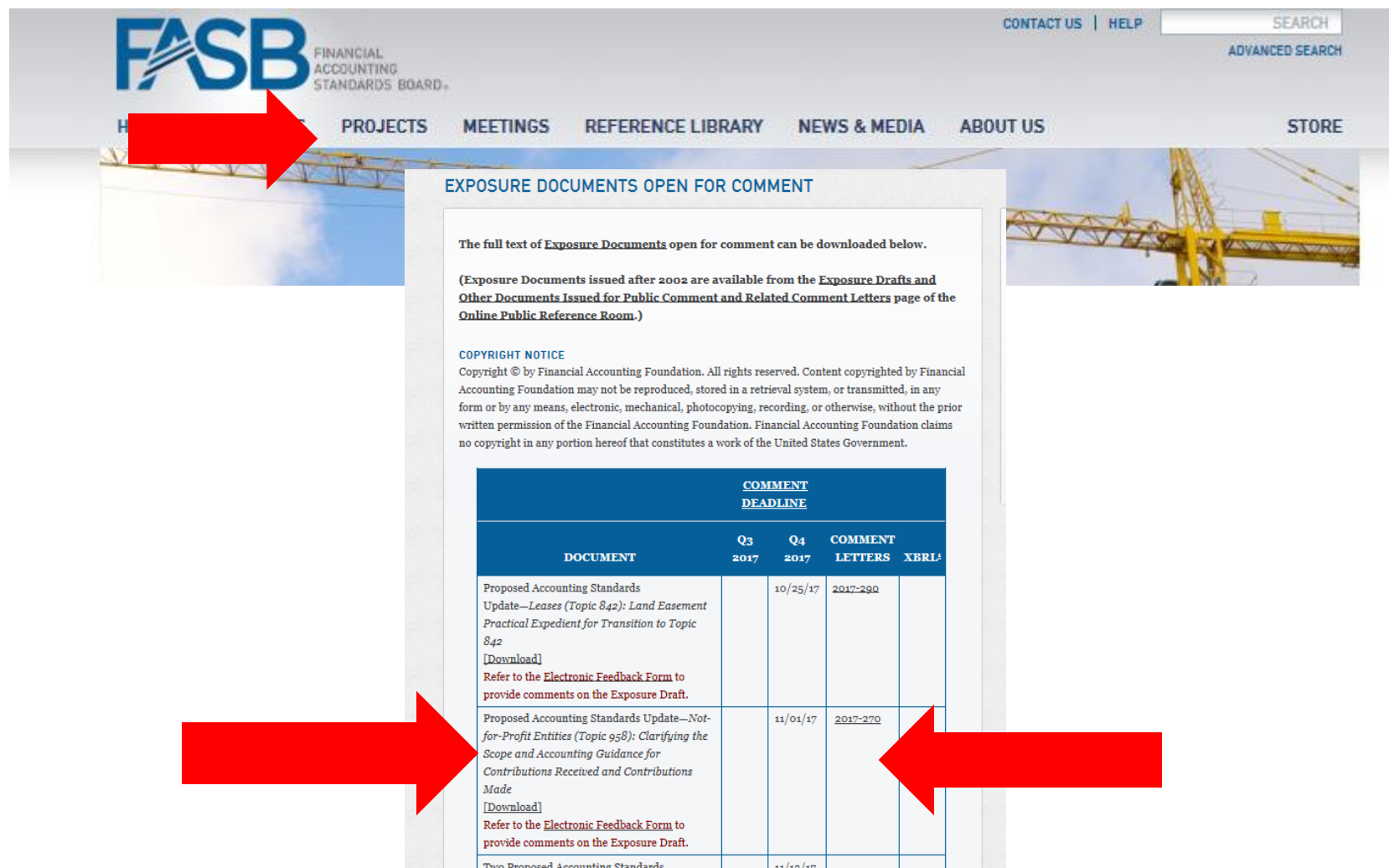
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Call to Action! FASB Wants to Hear from YOU!



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|---|------------------|----------|-----------------|-------------------|
| | Q3 2017 | Q4 2017 | | |
| Proposed Accounting Standards Update—Leases (Topic 842): <i>Land Easement Practical Expedient for Transition to Topic 842</i> [Download] Refer to the Electronic Feedback Form to provide comments on the Exposure Draft. | | 10/25/17 | 2017-290 | |
| Proposed Accounting Standards Update—Not-for-Profit Entities (Topic 958): <i>Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made</i> [Download] Refer to the Electronic Feedback Form to provide comments on the Exposure Draft. | | 11/01/17 | 2017-270 | |
| Two Proposed Accounting Standards | | 11/13/17 | | |

Call to Action! FASB Wants to Hear from YOU!

1. Would the amendments in this proposed Update provide clarifying guidance that would be operable in practice? If not, why not?
2. Would the proposed amendments clarify whether a resource provider is receiving commensurate value in return for assets transferred and when a transaction is within the scope of Subtopic 958-.05? If not, why not?
3. Should the definition of the term *donor-imposed condition* include both (a) a barrier that must be overcome and (b) a right of return of the assets transferred or a right of release of the promisor from its obligations to transfer assets? If not, why not?
4. Does the proposed table of indicators to describe a barrier provide useful guidance that will allow for the application of appropriate judgment? Should no single indicator be determinative? What changes should be made, if any, to the proposed indicators?
5. Should the proposed amendments about distinguishing between conditional contributions and unconditional contributions be applied equally to both the recipient and the resource provider?
6. Should certain other terms and/or their definitions be clarified (for example, *contribution* or *donor-imposed restriction*)? If yes, list which term(s) and/or definition(s) should be clarified, why they should be clarified, and any recommended changes.
7. Should current recurring disclosure requirements be amended for either a recipient or a resource provider? Should new disclosure requirements be added? If yes, what amendment(s) and/or addition(s) do you recommend? Please explain why.
8. Would the proposed transition requirements be operable, and would they provide decision-useful information? If not, please explain why and what you would recommend. Would modified prospective application be more operable than prospective application? If not, why not?
9. Should the effective date of the proposed amendments be the same as the effective date of Topic 606? Should early adoption of the proposed amendment be permitted?



Questions?

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