OCTOBER 2019

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Revenue Recognition for Not-for-Profit Organizations

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Johnson Lambert LLP is dedicated to keeping you current on the impact of the Financial Accounting Standards Board's (FASB) Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers* (ASC 606) and Accounting Standards Update (ASU) 2018-08, Not-for-Profit Entities (Topic 958) *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This white paper presents the most significant changes of applying the requirements of these standards to not-for-profit (NFP) revenue transactions.

Background

In 2014, the FASB issued ASU 2014-09, ***Revenue from Contracts with Customers***, the first of several ASU's that created and amended ASC 606. This standard sets out a single framework for revenue recognition and supersedes virtually all previous revenue recognition guidance. The standard is effective January 1, 2019 for nonpublic companies. However, NFPs that are defined by the guidance as public entities were required to apply the standard for annual periods beginning after December 15, 2017.

The FASB also issued ASU 2018-08, ***Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made***. This standard provides a framework to determine when a transaction should be accounted for as a contribution under ASC 958-605 or an exchange transaction under ASC 606. For contribution recipients (contributions received), the standard is effective January 1, 2019 for nonpublic companies and for annual periods beginning after June 15, 2018 for public companies. For contribution providers (contributions made), the standard is effective January 1, 2020 for nonpublic companies and for annual periods beginning after December 15, 2018 for public companies.

Exchange Transactions within the Scope of Topic 606

Exchange transactions[1] that may fall within the scope of ASC 606 include:

In Scope:

- Membership dues
- Tuition and housing revenue
- Exchange grants and awards
- Meetings, workshops, and conference revenue
- Publications revenue
- Product sales
- Sponsoring revenue
- Program fees

Not In Scope:

- Rental income
- Contributions
- Leases
- Insurance reimbursements
- Non-monetary exchanges and grants

For example, NFP A (a trade association) enters into a contract with Member X to provide the following member benefits: subscription to a quarterly medical journal, liability insurance coverage, networking and community, and career services. The fee for a one-year membership is $235.

We will use this example (shown in blue, italicized font) throughout the Topic 606 discussion to illustrate the five-step model. Additional examples are shown in orange, italicized font.

Topic 606 Revenue Recognition Model

The **core principle** of the new revenue recognition model is that an entity recognize revenue that represents the transfer of promised goods or services to customers in an amount reflective of the price the entity expects to be entitled to in exchange for those goods or services.

To satisfy the core principle, an entity would apply, document and conclude on the Five Step Model.

1

Step 1

Identify the contract with the customer

2

Step 2

Identify the performance obligations

3

Step 3

Determine the transaction price

4

Step 4

Allocate the transaction price to the performance obligations

5

Step 5

Recognize revenue when (or as) the entity satisfies a performance obligation

[1] *The list in this white paper is not intended to be complete. Each NFP should review its revenue transactions to determine whether the transaction meets the definition of an exchange transaction as defined in the FASB ASC glossary.*

1 Identify the Contract with the Customer

The guidance defines a contract as “an agreement between two or more parties that creates enforceable rights and obligations.”

A contract exists if all of the following conditions are met:

1. The parties have approved the contract and are committed to perform their respective obligations. The approval may be in writing, an oral agreement or based on customary business practices.
2. The contract identifies the goods or services to be provided and the parties’ rights regarding such goods or services.
3. Payment terms, which could be fixed, variable or both, are established and identifiable.
4. The contract has commercial substance, meaning the parties’ future cash flows will change as a result of the contract.
5. It is probable the NFP will collect the consideration it is due under the contract.

The AICPA Financial Reporting Executive Committee (FinREC) believes the above criteria have generally been met for membership dues that are exchange transactions when payment is received when there is no written contract.

For instance, if an NFP bills a member in advance for its membership renewal, it is unlikely that the criteria for a contract have been met until one party performs (generally when payment is received by the NFP).

Contract Duration (and Termination Rights)

The contract duration is the period in which the parties to the contract have present **enforceable rights and obligations**. Determining the contract’s duration is key as it could affect the identification of performance obligations and transaction price. Termination provisions should be considered as these provisions affect the contract duration. The guidance states “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.” A contract is considered **wholly unperformed** when: (1) services have not been transferred to the customer and (2) the entity has not received, and is not entitled to receive, consideration for such services.

Therefore, a one year contract containing a termination clause that allows either party to terminate the contract with a 30 day notice, without penalty, may require the entity to account for the contract as a monthly contract with a renewal option. The duration of a contract with a significant termination penalty is the period through which a termination penalty is due. In the event the termination penalty is due before the end of the stated term, the termination penalty should be reflected in the transaction price.

The contract between NFP A and Member X has a fixed term of one year and cannot be canceled. Therefore the contract duration is one year.

Portfolio of Contracts

As a practical expedient, similar contracts need not be analyzed separately provided their provisions are materially consistent with one another.

NFP A treats all noncancellable individual membership contracts as a portfolio of contracts rather than analyzing each individual membership contract separately as they have similar provisions.

2 Identify the Performance Obligations

Once the contract is identified, the next step is to identify each performance obligation. Each distinct good or service (performance obligation) is accounted for separately. A distinct good or service is one that is clearly distinct in the contract and benefits the member on its own or in conjunction with other resources. An indication that a good or service is distinct is if an NFP regularly sells the good or service on a standalone basis.

A performance obligation is defined as a contractual promise to transfer to the member either:

- A good or service (or a bundle of goods or services) that is distinct, or

Subscription to a quarterly medical journal

- A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the member. Such goods or services may be recognized over a period of time and treated as a single performance obligation.

  Liability insurance coverage, networking and community, and career services are provided as needed throughout the membership period.

NFP A determined the liability insurance coverage, networking and community and career services have the same pattern of transfer (daily) and each meets the definition of a series.

Contracts may contain goods or services that are not distinct. In those circumstances, non-distinct goods or services should be bundled together until one or more distinct bundles of goods or services are identified. Factors that indicate bundling is appropriate include goods or services that must be integrated in order to deliver the contracted good or service to the member, the good or service significantly modifies or customizes another good or service, or the goods or services are interdependent or interrelated.

Additional Promises Implied or by Specific Statements

Additional promises implied or specifically stated that provide a member with material rights are required to be considered. For example, the right to a discount on a future conference.

Assume as part of membership dues a member receives a discount to attend the annual conference. The NFP determines that 90% of the annual conference attendees are members. The NFP may conclude that the discount is a material right. Conversely, if the NFP determines that 25% of the annual conference attendees are members the NFP may conclude that the discount is not a material right.

3 Determine the Transaction Price

The transaction price is the amount an NFP expects to receive in exchange for providing goods or services. The transaction price may be fixed, variable or both, and may be affected by the following components:

- Variable consideration including variable consideration with constraints and refund liabilities

  There is an obligation to provide a student a partial or full refund upon the student's withdrawal.

- Significant financing provision - To the member's benefit

  There is a significant lag between when the service is performed and payment is due.

- Significant financing provision - To the NFP's benefit

  The NFP receives payment long before the service is performed (upfront payment).

  The guidance provides factors that, if present, indicate no financing provisions exist. For example, a member purchases the right to complete an on-line exam within a window that exceeds one year. In this example, a financing provision does not exist.

- Non-cash consideration

  A member contributes goods or services, for example materials, equipment, or labor, to facilitate the fulfillment of a contract. The NFP should assess whether it obtains controls of those contributed goods or services. If the NFP determines that control is obtained of contributed goods or services, the NFP would account for those contributed goods or services as noncash consideration received from the member.

- Consideration payable to a customer

  An educational institution awards a student a scholarship.

As a practical expedient, the transaction price is not adjusted for a financing provision if the NFP expects, at the start of the contract, the period of time between the transfer of goods or services to the member and payment by the member will be less than one year.

In most instances, the transaction price for membership dues is equal to the contract price.

NFP A has determined the transaction price is equal to the membership fee, which is $235 as the contract doesn't include any of the above components.

4 Allocate the Transaction Price to the Performance Obligations

If a contract has multiple performance obligations, an NFP should allocate the transaction price to each performance obligation on a **standalone** selling price basis. An NFP must **estimate** the standalone selling price when one is not readily observable, using one of the following approaches:

- Adjusted market assessment approach - Use of competitors' prices for similar goods or services adjusted to reflect the NFP's costs and margins
- Expected cost plus a margin approach - Forecast the expected cost to provide the good or service plus a margin to reflect what the market is willing to pay
- Residual approach - Subtract the sum of observable standalone selling prices of other goods or services from the total transaction price. This approach is allowed only when certain circumstances are met
- A combination of these approaches

When the transaction price includes a discount, the discount is generally allocated on a prorata basis to all performance obligations in the contract. However, in certain situations where observable evidence is available, the discount may be allocated to specific performance obligations.

NFP A sells its quarterly medical journal to medical libraries at a cost of $15 each issue, which NFP A has determined is the observable price.

Aside from the quarterly medical journal, NFP A does not sell member benefits independently. Therefore, no direct observable price for member benefits exists. Using the adjusted market assessment approach NFP A had determined the stand alone price of member benefits is $200.

First, determine the allocation percentage of each performance obligation. Next, allocate the transaction price (set at $235 from step 3) to each performance obligation using the calculated allocation percentages:

Performance obligation	*Stand Alone Price*	*Percentage of Stand Alone Price*	*Allocation of transaction price*
Medical journal quarter 1	*$15*	*5%*	*$11.75*
Medical journal quarter 2	*$15*	*5%*	*$11.75*
Medical journal quarter 3	*$15*	*5%*	*$11.75*
Medical journal quarter 4	*$15*	*5%*	*$11.75*
Member benefits	*$200*	*80%*	*$188*
	$260	*100%*	*$235*

Subsequent changes to or reassessments of the transaction price are allocated in the same manner used at contract inception. However, the transaction price may not be modified due to subsequent changes to standalone selling prices.

5 Recognize Revenue when a Performance Obligation is Satisfied

The final step in the model is to recognize revenue for each performance obligation based on the respective allocated price as the service is performed. Performance occurs when control is transferred to the customer, which may be at a **point in time or over time**. An NFP recognizes revenue over time if a member receives and consumes the benefits of the goods or services as they are transferred.

When performance obligations are **satisfied over time**, an NFP must elect **a single method** by which to measure its progress toward the completion of each performance obligation. Such method should be used for the duration of the contract and applied to similar performance obligations under similar contracts. Appropriate methods for measuring progress include the input and output methods.

Under the input method, revenue is recognized based on the NFP's efforts relative to the total efforts expected to satisfy the performance obligation. It may be appropriate to recognize revenue on a straight-line basis if the efforts are dispensed evenly throughout the performance period.

Under the output method, revenue is recognized based on the value of the goods or services transferred to the member to date relative to the remaining goods or services promised under the contract. Methods may include milestones reached, resources consumed or labor hours expended.

NFP A recognizes revenues as follows:

Medical journal – NFP A has concluded the performance obligation related to the medical journal is satisfied each quarter as the journal is issued or otherwise made available to the member. Thus $11.75 will be recognized as revenue each quarter (a point in time) as the journal is made available.

Member benefits – NFP A has concluded the performance obligation related to member benefits is satisfied throughout the membership period as member benefits are received and consumed simultaneously during the membership period. Thus, $188 will be recognized as revenue ratably over the membership period (over time).

The measure of progress should be updated to reflect changes in the outcome of the performance obligation at each measurement date and recorded as a change in accounting estimate.

Other Considerations

Bifurcation of Transactions Between Contribution and Exchange

NFP transactions that are part contribution and part exchange are bifurcated and accounted for under the appropriate revenue recognition guidance.

Assume an NFP has a scholarship program. Members may contribute to scholarship program when they apply for membership. Member X submitted its membership application with a check for $335; $100 contribution to the scholarship program and $235 membership fee. The NFP accounts for this as two transactions. The $100 contribution to the scholarship program is accounted for under ASC 958-605. The $235 membership fee is accounted for under ASC 606.

Billing in Advance and Receivables

NFPs often bill members for membership dues, journal subscriptions, etc. prior to the start of the service period. FinRec believes the contract criteria is generally not met until one of the parties to the contract performs. Therefore, an NFP should not record a receivable for advance billings until it satisfies a performance obligation or, under a noncancellable contract, when the NFP has an unconditional right to consideration.

Lifetime Membership

Certain NFP organizations offer lifetime memberships. NFPs that receive nonrefundable payment for lifetime membership must determine whether the performance obligation under the lifetime membership is satisfied over time or at a point in time. If the performance obligation is determined to be satisfied over time, revenue is recognized over an appropriate time period (e.g., the life expectancy of the member). If the performance obligation is not satisfied over time, an NFP should use the following indicators to determine the point in time the performance obligation is met and revenue is recognized:

- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance

Exercise of a Material Right

If an NFP provides members a discount to attend the annual conference, the NFP should assess whether the discount provides a material right to the member. If the discount is determined to be a material right, the NFP should assess the need to allocate a portion of the transaction price to the material right.

Revenue is recognized for material rights when the option is exercised or expires.

Disclosures

The guidance requires a nonpublic entity to disclose:

- Revenue recognized from contracts with customers, disclosed separately from other sources of revenue, on the face of the financial statements or in the notes to the financial statements
- Impairment losses on receivables or contract assets, from contracts with customers, disclosed separately from other impairment losses
- Revenue recognized from contracts with customers, disaggregated according to the timing of transfer of goods or services (e.g., at a point in time, over time)
- Qualitative information concerning how economic factors affect the nature, timing and uncertainty of revenues and cash flows
- Opening and closing balances of receivables, contract assets and contract liabilities, on the face of the financial statements or in the notes to the financial statements
- Revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods
- Description of its performance obligations:
    - When performance obligations are satisfied (e.g., upon delivery, as goods or services are rendered, upon completion of service)
    - Significant payment terms
    - Obligations for refunds or other similar obligations
- Significant judgments and subsequent changes, made when determining the timing of satisfaction of performance obligations, the transaction price and amounts allocated to performance obligations, including:
    - Methods used to recognize revenue for contracts satisfied over time (i.e. output or input method)
    - Methods, inputs and assumptions used to assess whether an estimate of variable consideration is constrained

Transition

ASC 606 may be adopted using a full or modified retrospective approach. Entities that elect to use practical expedients must disclose that fact and the qualitative assessment of the effect, if practical. Nonpublic entities are required to make the following disclosures in the year of adoption.

Full Retrospective Approach

- Adoption of the standard
- Prior year financial statements have been retrospectively adjusted (restated)
- Cumulative effect on net assets
- The effect of the change on impacted financial statement line items. Disclosure of the effect on financial statement totals and subtotals. Disclosure of the effect of the changes on the current period is not required.
- Practical Expedients
    - Contracts that begin and end in the same period are not required to be restated
    - Completed contracts with variable consideration may use the final transaction price
    - For periods presented prior to the date of adoption, an entity may elect to not disclose when it expects to recognize in revenue the transaction price allocated to remaining performance obligations
    - For contracts modified prior to the beginning of the earliest period presented, an entity may reflect the aggregate effect of such modifications that occurred prior to the beginning of the earliest period when:
        - Identifying the satisfied and unsatisfied

- performance obligations
- Determining the transaction price
- Allocating the transaction price to the satisfied and unsatisfied performance obligations.

Modified Retrospective Approach

- Adoption of the standard
- Recognize a cumulative effect adjustment to the beginning net asset balance
- Whether the standard was applied to all contracts or to contracts not completed as of the date of adoption
- The effect of the change on impacted financial statement line items in the current reporting period and an explanation of significant changes
- Practical expedient:
    - For contracts modified prior to the beginning of the earliest period presented, an entity may reflect the aggregate effect of such modifications that occurred prior to the beginning of the earliest period presented when:
        - Identifying the satisfied and unsatisfied performance obligations
        - Determining the transaction price
        - Allocating the transaction price to the satisfied and unsatisfied performance obligations.

Topic 958- 605 Not-For-Profit Entities - Revenue Recognition

In conjunction with the Topic 606 revenue recognition project, FASB issued ASU 2018-08. The ASU clarifies two aspects of NFP revenue recognition. First, the ASU clarifies when an NFP transaction is reciprocal and accounted for under Topic 606 versus nonreciprocal and accounted for under Topic 958-605. Second, the ASU clarifies when a donor contribution, accounted for under Topic 958-605 includes a donor-imposed condition versus a donor contribution that is unconditional.

Reciprocal versus Nonreciprocal

The FASB revised its definition of contribution to provide clarity on which transactions are reciprocal transfers (exchange transactions) and nonreciprocal transfers (contributions). Contribution is defined as:

An unconditional transfer of cash or other assets, as well as unconditional promises to give, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from:

- Exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately commensurate value;
- Investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners;
- Other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers.

Whether a transfer is reciprocal versus nonreciprocal transactions is largely determined by an NFP's interpretation of commensurate value. The ASU clarifies the following factors do not affect the existence of commensurate value:

> The resource provider (including a foundation, a government agency, a corporation, or other entity) is not synonymous with the general public. A benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider. Therefore, if the resource provider receives indirect value in exchange for the assets transferred or if the value received by the resource provider is incidental to the potential public benefit from using the assets transferred, the transaction shall not be considered commensurate value received in return.
>
> Execution of the resource provider's mission or the positive sentiment from acting as a donor shall

not constitute commensurate value received by the resource provider for purposes of determining whether the transfer of assets is a contribution or an exchange.

Indicators that an exchange transaction (reciprocal transfer) exists, and should be accounted for under ASC 606, include:

An expressed intent by the resource provider and the NFP to exchange resources for goods or services that are of commensurate value

The resource provider and the NFP agree on the amount of assets transferred in exchange for goods or services that are of commensurate value

Contractual provisions for economic forfeiture beyond the amount of assets transferred by the resource provider to penalize the NFP for nonperformance

Indicators that a contribution transaction (nonreciprocal transfer) exists, and should be accounted for under ASC 958-605, include:

The NFP solicits assets from the resource provider without the intent of exchanging goods or services of commensurate value

The resource provider has full discretion in determining the amount of the transferred assets

The penalties assessed on the NFP for failure to comply with the terms of the agreement are limited to the delivery of assets or services already provided and the return of unspent amounts.

Commensurate Value

NFP is awarded a research grant from a federal government agency to study the benefits of a longer school year. The award has the following stipulations:

- *Comply with the requirements of Uniform Guidance*
- *Incur qualifying expenses*
- *Unspent funds are to be returned to the agency*
- *Submit a summary of research findings to the agency. However, the NFP retains the publishing rights of the findings.*

Because the NFP retains the rights to the research and findings, the federal agency (resource provider) does not receive commensurate value and the transaction is accounted for as a contribution under ASC 958-605.

Assume the NFP planned and performed the research, and summarized and submitted the results to the government agency who retains all rights to the data. In this example, the federal agency (resource provider) receives direct commensurate value and the transaction is accounted for as an exchange transaction under ASC 606.

Donor-imposed Condition versus Unconditional

A donor-imposed condition is defined as “a donor stipulation that represents a barrier that must be overcome before the recipient is entitled to the assets transferred or promised. Failure to overcome the barrier gives the contributor a right of return of the assets it has transferred or gives the promisor a right of release from its obligation to transfer its assets.” A barrier places specific requirements on an NFP about the use of transferred assets to be entitled to those assets.

An unconditional contribution is one without donor-imposed conditions (barriers) and the related revenue is recognized in the period it is received. Conversely, a conditional contribution is one with barriers and the related revenue is recognized when the barriers are substantially met or explicitly waived by the donor.

Indicators a barrier exists may include:

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 are often coupled with a time limitation (for example, indicating that the outcomes are to be achieved within a specified timeframe).

Examples of measurable performance-related barriers include a requirement that indicates that a recipient's entitlement to transferred assets is contingent upon the achievement of any of the following:

A. A specified level of service
B. An identified number of units of output
C. A specified outcome.

Other measurable barriers stipulate that a recipient is entitled to the resources if an identified event occurs (for example, a matching requirement).

Limited Discretion by the Recipient on the Conduct of an Activity

- A requirement to follow specific guidelines about incurring qualifying expenses
- A requirement to hire specific individuals as part of the workforce conducting the activity
- A requirement to adhere to a specific protocol

Stipulations That Are Related to the Purpose of the Agreement

- A requirement for a food pantry to provide a specified number of meals to the homeless
- A requirement for a food pantry to expand its geographic service area
- A requirement for a research report that summarizes the findings from a grant on the effects of homelessness on children

Other Considerations

Donor-Imposed Stipulations

Contributions that do not contain donor-imposed conditions may contain donor-imposed stipulations. When determining whether a donor-imposed stipulation exists, a NFP should consider "how broad or narrow the purpose of the agreement is and whether the resources can be used only after a specified date." Donor-imposed stipulations determine whether an unconditional contribution is recorded as an increase in net assets with donor restrictions or as an increase in net assets without donor restrictions.

Ambiguous Donor Stipulations

An NFP shall presume a contribution is conditional when donor stipulations are not clearly unconditional.

Conditional Assets Received

Assets received as conditional contributions are accounted for as a refundable advance liability until the conditions have been substantially met or explicitly waived by the donor.

Probability Assessments

Whether an NFP is likely to meet donor-imposed stipulations is not a factor when determining whether an agreement contains a barrier.

Limited Discretion vs. Donor-Imposed Stipulation

When considering whether a barrier exists, limited discretion is more specific than donor-imposed stipulations. Limited discretion places limitations on how an activity is performed. Donor-imposed stipulation limit the use of a contribution to specific activity or time.

Administrative and Trivial Stipulations

Administrative and trivial stipulations are not indicative of a barrier and may include requirements to provide:

- An annual report
- A report summarizing the steps taken to meet the barriers specified in the agreement.

Simultaneous Release Option

An NFP may adopt a policy to report a specified group of donor-restricted contributions that were initially conditional contributions in which the conditions have been met in the same period as revenue without electing the policy for other donor-restricted contributions. The NFP is required to apply the policy consistently from period to period and to disclose the accounting policy.

Existence of Barriers

An NFP is awarded a grant to provide career training to disabled veterans, which contains the following stipulation:

- *Provide training to at least 8,000 disabled veterans (minimum of 2,000 per quarter)*

The NFP will receive payment quarterly upon demonstrating it served at least 2,000 disabled veterans. If the NFP does not meet the minimum requirement of 2,000 veterans served in a quarter, the resource provider is released from its obligation to transfer payment.

In this example, the conditional contribution includes a measurable performance barrier in which the NFP is entitled to transfer assets upon meeting a minimum requirement. The NFP recognizes revenue when the barrier is overcome.

Implementation Guidance

The FASB provides a decision tree in ASC 958-605-55-1A to assist in determining whether transactions are exchange transactions or contributions, and whether contributions are conditional or unconditional.

Transition Guidance and Disclosures

The ***ASU 2018-08*** should be applied using a modified prospective basis. However, retrospective application is allowed.

Modified Prospective Application

The following disclosures are required:

- 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 period as a result of adopting the standard
- Disclosures required for a change in accounting principle

The standard should be applied to all agreements entered into after the date of adoption or agreements effective at the date of adoption, only to the portion of revenue not previously recognized. Prior period results should not be restated and no cumulative-effect adjustment should be made to opening net assets.

The content contained herein should not be relied upon as accounting or tax advice as it does not take into account any specific organization's facts and circumstances.

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