Dannible & McKee, LLP

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Top Ten Accounting Best Practices with a Side of Revenue Recognition

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Accounting Standards Update Contributions Received and Made

- The FASB issued ASU 2018-08 in June 2018 clarifying the scope and the accounting guidance for contributions received and contributions made.
- The amendments will assist entities in:
  - Evaluating whether transactions should be accounted for as contributions within the scope of Topic 958 or as;
  - Exchange transactions subject to Topic 606 – Revenue from Contracts with Customers.
  - Further to distinguish between conditional contributions and unconditional contributions.

Accounting Standards Update Contributions Received and Made

Is the transaction one in which each party directly receives commensurate value?

- **Yes** → It is an exchange transaction. Apply Topic 606 on revenue from contracts with customers.
- **No** ↓

Is the payment a transfer of assets that is part of an existing exchange transaction between a recipient and an identified customer or another transaction outside the scope of contributions received.

- **Yes** → Outside the scope of this Subtopic. Apply other Topics.
- **No** ↓

Accounting Standards Update Contributions Received and Made

It is a nonreciprocal transaction. Apply contribution (nonexchange) guidance.

Is there a donor-imposed condition or conditions present (a barrier and a right of return/right of release must exist)?

No

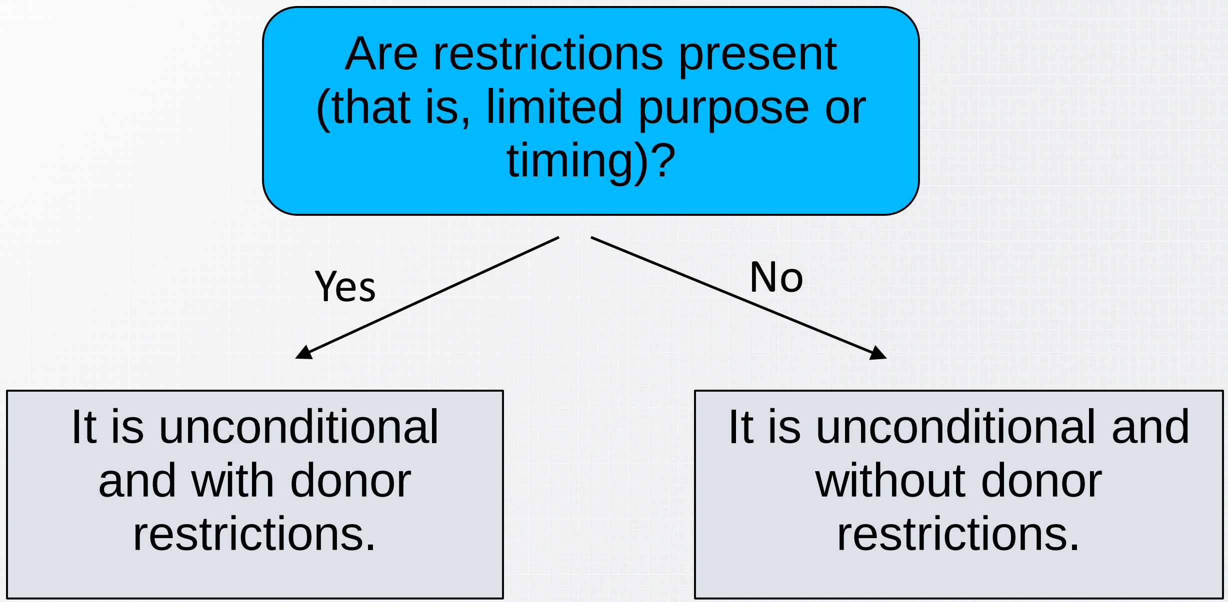
Yes

It is conditional. Recognize when the condition or conditions are met.

Meeting of Condition

It is unconditional. Recognize revenue in appropriate net asset class.

Accounting Standards Update Contributions Received and Made



Accounting Standards Update Contributions Received and Made

If the transaction is deemed to be a contribution then the following needs to be considered:

- Donor Imposed Condition – new definition
  a. Is there a barrier the nonprofit must overcome to be entitled to the resources provided <u>and</u>
  b. Does the contributor retain either a right of return to the resources provided or a right of release of promisor from its obligation to transfer resources.
- Barrier
  a. The nonprofit is required to achieve a measurable outcome (help a specific number of beneficiaries or produce a certain number of units).
  b. The nonprofit is required to overcome a barrier related to the primary purpose of the agreement (this excludes trivial or administrative requirements).
  c. The nonprofit has limited discretion over how the resources are spent (a requirement to follow specific guidelines about incurring qualifying expenses).

Accounting Standards Update Contributions Received and Made

- Effective Dates – for most organizations
  - For **resource recipients -** annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019 (Calendar year 2019)
  - For **resource providers -** annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020 (Calendar year 2020)
- Transition
  - Modified prospective basis; retrospective basis is permitted
- Disclosure
  - 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.

Example: Exchange Transaction

Not-for-Profit Entity A is a large research university with a cancer research center. NFP A regularly conducts research to discover more effective methods of treating cancer and often receives contributions to support its efforts. NFP A receives resources from a pharmaceutical entity to finance the costs of a clinical trial of an experimental cancer drug the pharmaceutical entity developed. The pharmaceutical entity specifies the protocol of the testing, including the number of participants to be tested, the dosages to be administered, and the frequency and nature of follow-up examinations. The pharmaceutical entity requires a detailed report of the test outcomes with two months of the test's conclusion. The rights to the results of the study belong to the pharmaceutical entity.

Because the results of the clinical trial have particular commercial value for the pharmaceutical entity, the pharmaceutical entity is receiving commensurate value as the resource provider. Therefore, Topic 606 – Revenue from Contracts with Customers is followed.

Example: Exchange Transaction

The local government provided funding to NFP C to perform a research study on the benefits of a longer school year. The agreement requires NFP C to plan the study, perform the research, and summarize and submit the research to the local government. The local government retains all rights to the study.

NFP C concludes that this is a procurement arrangement in which commensurate value is being exchanged between two parties and that it should follow the relevant guidance for exchange transactions. NFP C is to perform a research study for the local government and turn over a summary of the study's findings to the local government. The local government retains the rights to the study. Therefore, Topic 606 – Revenue from Contracts with Customers is followed.

Example: Promise to Give

In 2015, an individual notifies Church F that she has remembered the church in her will and provides a written copy of the will. In 2016, the individual dies. In 2017, the individual's last will and testament enters probate and the probate court declares the will valid. The executor informs Church F that the will has been declared valid and that it will receive 10 percent of the individual's estate, after satisfying the estate's liabilities and certain specific bequests. The executor provides an estimate of the estate's assets and liabilities and the expected amount and time for payment of Church F's interest in the estate.

The 2015 communication between the individual and Church F specified an intention to give. The ability to modify a will at any time prior to death is well established; thus in 2015 Church F did not receive a promise to give and did not recognize a contribution received.

Example: Promise to Give, Continued

When the probate court declares the will valid, Church F would recognize a receivable and revenue for an unconditional promise to give at the fair value of its interest in the estate. If the promise to give contained in the valid will was instead conditional based on a barrier that must be overcome for Church F to be entitled to the assets conditioned on a future and uncertain event, Church F would recognize the contribution when the condition was substantially met.

Example: Measurable Performance

Foundation A gives NFP D a grant in the amount of $400,000 to provide specific career training to disabled veterans. The grant requires NFP D to provide training to at least 8,000 disabled veterans during the next fiscal year (2,000 during each quarter), with specific minimum targets that must be met each quarter. Foundation A specifies a right of release from the obligation in the agreement that it will only give NFP D $100,000 each quarter if NFP D demonstrates that those services have been provided to at least 2,000 disabled veterans during the quarter.

Foundation A determines that it should account for this grant as conditional. The agreement contains a right of release from obligation because the resource provider will only transfer assets if NFP D provides training to at least 8,000 disabled veterans during the year (with a minimum requirement of 2,000 disabled veterans per quarter) as specified in the agreement.

Example: Measurable Performance, Continued

Foundation A requires NFP D to achieve a specific level of service that would be considered a measurable performance-related barrier (in the form of milestones by specifying 2,000 disabled veterans per quarter). In this Example, NFP D's entitlement to the transferred assets is contingent upon serving at least 2,000 disabled veterans.

The contribution is recognized as revenue as the milestones are met. If an advance is received, this would be recorded in deferred revenue until the milestone is met.

Example: Qualifying Expenses

NFP B is a hospital that has a research program. NFP B receives a $300,000 grant from the Federal awarding agency to fund thyroid cancer research. The terms of the grant specify that NFP B must incur certain qualifying expenses (or costs) in compliance with rules and regulations established by the Office of Management and Budget and the Federal awarding agency. The grant is paid on a cost-reimbursement basis by NFP B initiating drawdowns of the grant assets. Any unused assets are forfeited, and any unallowed costs that have been drawn down by NFP B are required to be refunded.

NFP B determines that this grant is conditional. The grant agreement limits NFP's discretion as a result of the specific requirements on how NFP B may spend the assets (incurring certain qualifying expenses in accordance with the Office of Management and Budget rules and regulations). The grant also includes a release from the promisor's obligation for unused assets.

Example: Qualifying Expenses, Continued

The requirement to spend the assets on qualifying expenses is a barrier to entitlement because the requirement limits NFP B's discretion about how to use the assets, and the assets would need to be spent on specific items on the basis of the requirements of the agreement (for example, adherence to cost principles) before NFP B is entitled to the assets. This is in contrast to a restriction that typically places limits only on a specific activity that is being funded. NFP B records revenue during the grant period when the barriers have been overcome as it incurs qualifying expenses.

Example: Research Grant

NFP E is a public charity that performs research on various diseases and allergies, including gluten-related allergies, as part of its overall mission. It receives a $100,000 grant from a foundation to perform research on gluten-related allergies over the next year. The grant agreement includes a right of return as part of the foundation's standard wording and a requirement that at the end of the grant period a report must be filed with the foundation that explains how the assets were spent.

NFP E determines that the grant is not a conditional contribution. The purpose of research on gluten-related allergies results in donor-restricted revenue because the purpose of the grant (working on gluten-free allergies) is narrower than the overall mission of the entity.

Example: Research Grant, Continued

There are no requirements in the agreement that would indicate that a barrier exists, which must be overcome before the recipient is entitled to the resources. NFP E also determines that the reporting requirement alone is not a barrier because it is an administrative requirement and not related to the purpose of the agreement, which is the actual research. This is an example in which a grant, including a right of return, could not be considered conditional because the return clause is not coupled with a barrier to be overcome, as determined by NFP E using judgment to assess the indicators of a barrier.

Example: Hospital Contribution

NFP DD is a hospital that received an upfront cash contribution from an individual to perform research on Alzheimer's disease during NFP DD's next fiscal year. The agreement does not include a right of return or a barrier that must be overcome to be entitled to the funds.

NFP DD determines that this contribution is not conditional because it does not include a right of return (or similar language) of the assets that have been transferred upfront. NFP DD concludes that it should recognize the revenue upon receipt of the assets from the individual as donor-restricted because it is required to use the assets for Alzheimer's research, which is narrower than NFP DD's overall mission, during the next fiscal year.

Example: Contribution from a Foundation

Foundation B receives a grant proposal from an animal rescue facility, NFP F, which requests a 2-year grant in the amount of $500,000 upfront to be used to expand its operations. The agreement indicates that NFP F must expand its facility by at least 5,000 square feet to accommodate additional animals by the end of the 2 years. The grant contains a right of return if the minimum expansion target is not achieved.

Foundation B determines that this grant is conditional. The grant includes a measurable barrier (5,000 additional square feet) that must be achieved by NFP F to be entitled to the assets and a right of return for unused assets or unmet requirements.

Example: Contribution to a University

NFP G is a university that is conducting a capital campaign to build a new building to house its school of mathematics and to make capital improvements to existing buildings on campus, including a new heating system and an upgraded telephone and computer network. NFP G receives an upfront grant in the amount of $10,000 from a foundation as part of its capital campaign. The agreement contains a right of return requiring that the assets be reimbursed to the resource provider if the assets are not used for the purposes outlined in the capital campaign solicitation materials. The resource provider does not include any specifications in the agreement about how the building should be constructed or on how other improvements should be made.

NFP G determines that this grant is not conditional because the agreement places limits only on the specific activity that is being funded.

Example: Contribution to a University, Continued

The assets can be used toward the new building or toward other capital improvements such as the heating system and an upgraded telephone and computer network within existing buildings on campus. The resource provider does not include any specifications about how the building should be constructed, and the agreement only indicates that NFP G must use the grant for the purpose outlined in the capital campaign materials. NFP G recognizes this grant as donor restricted revenue because it must be used for capital purposes, which is narrower than NFP G's overall mission. This Example illustrates a fact pattern in which a grant can include a right of return and would be deemed a contribution that does not contain a donor-imposed condition because the return clause is not coupled with a barrier to be overcome, as determined by NFP G using judgment to assess the indicators of a barrier.

Example: Contribution to a Museum

NFP I is a museum that receives a grant from an individual donor to build a new wing on the existing museum building. The agreement contains a $1 million multiyear promise to give the money to be used for the new wing on the building. The agreement also includes specific building requirements, including square footage and that the new wing must be environmentally friendly with Leadership in Energy and Environmental Design certification. The first installment of the gift will not be paid until NFP I submits architectural designs that meet the building requirements. Additional installments of the grant will be paid in specified increments upon achieving other milestones identified in the grant agreement. If a particular milestone is not achieved, the donor is released from its obligation to make installment payments.

Example: Contribution to a Museum, Continued

NFP I determines that this agreement is conditional because NFP I is not entitled to the assets until a milestone is met (for example, an architectural plan including square footage and Leadership in Energy and Environmental Design certification). In this Example, a milestone is deemed a measurable performance barrier because NFP I's entitlement to the transferred assets is contingent upon the completion of a milestone. In addition, the agreement includes a release of the resource provider's obligation to transfer assets if the stipulations are not met. NFP I recognizes the revenue as the barriers are overcome, which is upon meeting the specific requirements as NFP I builds the new wing.

Example: Contribution to a Homeless Shelter

NFP J operates as a homeless shelter that provides individuals with temporary accommodations, meals, and counseling. NFP J receives an upfront grant of $75,000 from the city for its meals program. The grant requires NFP J to use the assets to provide at least 5,000 meals to the homeless. The grant contains a right of return for meals not served.

NFP J determines that this grant is conditional because it contains a measurable performance-related barrier (to provide 5,000 meals) and a right of return. NFP J recognizes assets received in advance of satisfying the conditions as a refundable advance liability and will then recognize $75,000 as donor-restricted revenue when at least 5,000 meals are served because the purpose of the grant is narrower than the overall purpose of NFP J.

Example: Recreational Organization

NFP H is a recreational organization that provides various sports programs to children that live in the community. NFP H receives an upfront grant in the amount of $40,000 from a foundation to be used toward its tennis program. Consistent with NFP H's grant proposal, the agreement includes specific guidelines for which NFP H could use the assets (for example, to hire 10 tennis instructors or to provide a summer camp for 9 weeks) but does not specify that NFP H's entitlement to the $40,000 is dependent upon NFP H meeting any of the specific indicated guidelines in the agreement. The grant contains a right of return for funds not spent on the tennis program.

NFP H determines that this grant is not conditional because it does not contain a barrier to overcome to be entitled to the transferred assets.

Example: Recreational Organization, Continued

Although the grant agreement contains guidelines for how NFP H could spend the $40,000, the agreement does not specify that entitlement to the transferred assets are dependent upon meeting any of the guidelines. Because the guidelines in the grant agreement were not required to be met to be entitled to the funding, the agreement does not contain a barrier to overcome. NFP H should recognize the revenue upon receipt of the assets as donor restricted because it is required to use the assets for the tennis program, which is narrower than NFP H's overall mission.

Top Ten Accounting Best Practices to Focus on in 2020!

10. Create or Maintain your Strategic Plan

- Where will your nonprofit be in 3 years? 5 years?
- Do you have a formal strategic plan?
- Strategic objectives should be set using a team approach

9. Make Realistic Fundraising Goals

- Set realistic fundraising goals and plans
- Use historical data to set your upcoming goals and develop a plan with these figures in mind
- Be flexible and adjust where needed

8. Develop and Utilize an Operating Budget

- Create a realistic operating budget
- Allow flexibility
- Develop an operating reserve policy
- Involve your Board

7. Utilize your Accounting Software

- Nonprofit software
- Cloud based options
- Streamline reporting
- Utilize software capabilities

6. Understand Nonprofit Tax and Accounting Regulations

- Nonprofit accounting can be complex – many changes the last two years
- IRS Requirements
- It's also important to strategize with professionals/advisors to understand the potential impacts of present and future tax laws.
- Consult with your experts!

5. Improving Board Involvement

- The Board of Directors is a critical component to the success or your organization.
- Board training and education on Organization
- Ensure Board expectations are communicated in writing
- Be strategic in the design of your Board

4. Improve Relationships with Other Departments

- Communication with other departments
- Consider setting regular meetings
- Hold trainings to help the departments understand the accounting side
- Work together for multi department reconciliations

3. Improve Financial Reporting

- Reviewing Balance Sheet, Income Statement and Cash Flow Projection Monthly
- Ensure timely reporting
- Board should be reviewing financial reports
- Compare to budget

2. Strengthen Internal Controls and Policies

- Fraud awareness
- Proactive not reactive
- Internal controls significantly improve your fraud protection
- Implementing a Code of Ethics

1. Segregation of Duties

- Utilizing your staff to segregate key functions
- Review who has access to your general ledger
- Review cash receipts procedures
- Review cash disbursement procedures

Questions

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