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Revenue Recognition for Nonprofit Organizations

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Outline

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- Briefly Discuss FASB *Accounting Standards Update* (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*
- Review the Five Step Model
- Discuss Revenue Streams Common with Nonprofit Entities
- Discuss Implementation Plan Strategies
- Identify Additional Resources

Objectives

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- Obtain a General Understanding of the Revenue Recognition Standard changes and the Five Step Model
- Obtain a General Understanding of the Revenue Recognition Standard effect on Nonprofits
- Obtain Ideas for Developing a Revenue Recognition Implementation Plan

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FASB *Accounting Standards Update* (ASU)No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

In May 2014 FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)

- Replaces virtually all existing guidance for revenue recognition of exchange transactions (excludes leases, financial instruments and insurance contracts)
- Affects all entities – public, private and NFP

In August 2015, FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date

- Most NFPs will apply standards for annual reporting periods beginning after 12/15/18

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FASB *Accounting Standards Update* (ASU)No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

Due to concerns regarding difficulty and diversity in practice among nonprofits regarding grants, FASB issued an exposure draft, Not-For-Profit Entities (Topic 958): *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, in August 2017

- The proposed ASU includes a flowchart to help with the determination of a contribution vs. and exchange.
- States that "In a Contribution transaction, the resource provider often receives value indirectly by providing social benefits. In an exchange transaction, the potential public benefits are secondary to the potential proprietary benefits to the resource provider."

FASB *Accounting Standards Update* (ASU)No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

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Impact on NFPs:

Statement of Activities

- Certain transactions will require bifurcation between exchange transaction and a contribution
- Treatment of **private and government grants** will depend on facts and circumstances – a grantor may not be considered a customer in an exchange transaction if not receiving something of approximate equal value but, rather, its constituents or society as a whole receives the respective value
- Contributions and investment income are not subject to this standard

FASB *Accounting Standards Update* (ASU)No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

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Impact on NFPs:

Statement of Financial Position

- When either party to a contract (exchange transaction) has performed, a contract asset or contract liability shall be presented
- Must present any unconditional rights to consideration separately as a receivable (if only passage of time is required before payment is due)

FASB *Accounting Standards Update* (ASU)No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

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Impact on NFPs:

Footnotes

Will require detailed qualitative and quantitative disclosures re:

- contracts,
- judgements made in applying guidance to the contracts
- Information about any assets recognized for contract costs
- Specific disclosure requirements related to tuition and housing revenues

Revenue from Contracts with Customers - Five Step Model

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To apply the proposed revenue recognition standard, ASU No. 2014-09 states that an entity should apply these five steps:

1. Identify the contract(s) with customers
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

Revenue from Contracts with Customers - Five Step Model

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1. **Identify the contract(s) with customers**
   - Does not need to be written; may be oral or implied by the entity's business practices, but in needs to create **legally enforceable rights and obligations** between the parties or it is not a contract.
   - Contract does not exist if each party has the unilateral right to terminate a **wholly unperformed** contract without compensation; or the **collectability threshold** is not met

Wholly unperformed – transfer of promised goods or services has not occurred AND the entity has not received, or entitled to receive, and consideration in exchange for the promised goods or services

Collectability threshold – entity must conclude that it is probable that it will collect the consideration

Revenue from Contracts with Customers - Five Step Model

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1. **Identify the contract(s) with customers**

Example: Trade association has a 6/30 year-end and bills its members for the upcoming year (7/1-6/30) on 3/31. Is there a contract with the member on 3/31 when it bills the member or when it actually receives the renewal payment?

Answer: Contract exists when renewal payment is received as the rights and obligations do not exists between the parties as the member has not accepted the "contract" until payment is made. Contract liability recorded at time of payment.

Revenue from Contracts with Customers - Five Step Model

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2. Identify the performance obligations in the contract

Performance Obligation – A promise in a contract to transfer goosd or services to the customer

- A good or service, or a bundle of goods or services, **that is distinct**; or
- A series of goods or services that are substantially the same and that have the same pattern of transfer to the customer

Revenue from Contracts with Customers - Five Step Model

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2. Identify the performance obligations in the contract

Example: A museum offers annual memberships for $200. The museum has determined that $100 is a contribution and the remaining $100 is a **contract** for benefits the member receives. How does the museum determine the **performance obligations**?

Answer: Performance obligations are the distinct goods or service to be provided the customer (membership benefits) such as:

1) Annual admission to the museum
2) Monthly newsletter
3) Attendance to annual luncheon

Revenue from Contracts with Customers - Five Step Model

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3. Determine the transaction price

Transaction Price – Amount of consideration the entity expects to receive in exchange for the promised goods/services.

Example: A museum offers annual memberships for $200. The museum has determined that $100 is a contribution and the remaining $100 is a contract for benefits the member receives. What is the transaction price?

Answer: The transaction price for the contract as a whole is $100

Revenue from Contracts with Customers - Five Step Model

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4. Allocate the transaction price to the performance obligations in the contract

- Should be based on stand-alone selling price.

Example: A museum offers annual memberships for $200. The museum has determined that $100 is a contribution and $100 is a contract. The performance obligations (POs) are considered to be the annual admission to the museum, the monthly newsletter and the right to attend the annual luncheon. How would the transaction price be allocated to the POs?

Answer: Allocate POs based on stand alone selling price

1) Annual admission to the museum - $60
2) Monthly newsletter - $10
3) Attendance to annual luncheon - $30

Revenue from Contracts with Customers - Five Step Model

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

- Control of the goods have been transferred or the services have been provided

Example: A museum offers annual memberships for $200. The museum has determined that $100 is a contribution and $100 is a contract. The performance obligations (POs) are considered to be: 1. annual admission $60; 2. monthly newsletter $10; 3. luncheon attendance $30. When is the revenue recognized?

Answer: Recognize when POs are satisfies

1) Annual admission $60 - $5/mo.
2) Monthly newsletter $10 - $0.83/mo.
3) Luncheon attendance $30 – immediately after the event

Revenue Streams Common with Nonprofit Entities

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Nonprofit entities have a wide variety of revenue streams for which revenue recognition policies should be documented. Examples include:

- Contributions
- Membership dues
- Sponsorship revenue
- Grants
- Investment income
- Retail sales
- Tuition
- Housing revenues
- Program service fees

Revenue Streams Common with Nonprofit Entities

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Membership Dues: Can be a Contribution, Exchange Transactions, or a combination of both

Indicators

- NFPs Intent of dues payment (for services to general public or members only)
- Extent of benefits to members (negligible or available to others for a fee)
- NFPs service efforts to members vs nonmembers
- Duration of benefits
- Refundability
- Qualifications for membership

Revenue Streams Common with Nonprofit Entities

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Membership Dues Examples:

A. NFP has annual dues of $100. The only benefit the members receive is a monthly newsletter with a fair value of $25.

1. Contracts - newsletter subscription

   (Deemed contribution of $75 as no specific identifiable benefit provided, there for not covered by the ASU)

2. Performance Obligations (POs) - 12 monthly newsletter editions

3. Transaction Price - newsletter value $25

4. Allocate Price to POs - newsletter value $25

5. Recognize Revenue as POs are satisfied - newsletter subscription $2.08 per month

When is contract liability recorded?

Revenue Streams Common with Nonprofit Entities

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Membership Dues Examples:

B. NFP has annual dues of $250. Members receive benefits from their dues such as advocacy efforts, technical resource guidance, and a quarterly professional magazine with fair value of $100

1. Contracts - 1) membership benefits, 2) magazine subscription
2. Performance Obligations (POs) - 1) membership services for 1 year, 2) 4 quarterly magazine editions
3. Transaction Price - Total of $250
4. Allocate Price to POs - 1) membership services $150, 2) Magazine subscription $100
5. Recognize Revenue as POs are satisfied - 1) membership dues $12.50 per month, 2) magazine subscription $25 per quarter

Revenue Streams Common with Nonprofit Entities

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Membership Dues Examples:

C. NFP has annual dues of $250 including a magazine with fair value of $100 OR dues for membership benefits of $175 without quarterly magazine. Evaluate the $250 membership.

1. Contracts - 1) membership benefits, 2) magazine subscription
2. Performance Obligations (POs) - 1) membership services for 1 year, 2) 4 quarterly magazine editions
3. Transaction Price - total of $250
4. Allocate Price to POs -
   - 1) membership services 175/275=64%, $250 x 64% = $160
   - 2) magazine subscription 100/275=36%, $250 x 36% = $90
5. Recognize Revenue as POs are satisfied -
   - 1) membership dues $13.33 per month,
   - 2) magazine subscription $22.50 per quarter

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

Student pays a nonrefundable enrollment deposit of $1000 prior to enrollment.

1. Contract: educational classes
2. Performance Obligations (POs) - educational classes
3. Transaction Price – $1000
4. Allocate Price to POs - educational classes $1000
5. Recognize Revenue as Pos are satisfied - $1000 recognized as classes provided over the semester

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

Student pays a nonrefundable enrollment deposit of $1000 prior to enrollment. What is the entry?

Statement of Financial Position Entry:

Debit Cash $1000

Credit Contract Liability $1000

- If student enrolls, deposit will be included in full enrollment transaction price.
- If student does not enroll $1000 recognized as revenue after enrollment deadline date.

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

Student enrolls: There is a 2-week withdrawal period (after classes start). A bill is sent to student for $9000 balance of tuition. What is the entry?

- No entry as the institution does not have an unconditional right to the consideration b/c of the 2-week withdrawal period

Bill is due 2 weeks prior to the first day of classes but is not paid. What is the entry?

- No entry because the student has withdrawal right

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

Institution provides the first day of classes of a 100 day semester (student has not paid bill). What is the entry?

Debit contract liability $91

Credit revenue $91

The institution adjusts the transaction price based on its estimate of refunds:

$10,000/100 days = $100 per day less refund estimate

($9,000/100 x 10% refund estimate) of $9 = $91 per day

The entry is repeated each day for the time remaining in the withdrawal period.

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

2-week withdrawal period ends (still no payment). What is the entry?

Debit Accounts Rec. $9000

Credit contract liability $9000

How does the revenue recognition change?

Daily revenue changes as contract is now non-cancellable

$9090/90 remaining days = $101 per day less

The entry is repeated each day for the time remaining in the semester.

Revenue Streams Common with Nonprofit Entities

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Tuition Example:

What if student paid bill before classes start? What is the entry?

- Record cash received

  Debit cash $9000

  Credit contract liability $9000

- Recognize an estimated refund liability (10% estimate assumed)

  Debit contract liability $900

  Credit refund liability $900

Revenue Streams Common with Nonprofit Entities

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Grant Example:

NFP to receive milestone payments on cancer research performed under a $60,000 grant from Dept of HHS. Dept of HHS will own the research that is developed and provided to HHS.

1. Contracts - research service
2. Performance Obligations (POs) - milestone obligations
3. Transaction Price - total of $60,000
4. Allocate Price to POs - amount assigned to each milestone
5. Recognize Revenue as POs are satisfied – recognize as research toward each milestone is performed, with an estimated allowance that they will not achieve the milestone

Revenue Streams Common with Nonprofit Entities

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Grant Example:

NFP to receive milestone payments on cancer research performed under a $60,000 grant from Dept of HHS. The NFP will own the research that is developed and provided to HHS and may publish findings if desired.

- Transaction is a contribution, as the grantor does not receive direct commensurate value in exchange for the funds provided. The NFP and the public receive the primary benefit of the research and findings.

Implementation Plan Strategies

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NFPs should develop an Implementation Plan.

Possible steps include:

- Determine training and education resources for staff
- Compile a list of all of the NFPs entities' revenue streams
- Develop and document a position of each revenue stream
- Determine if revenue recognition change is required
- Consider impacts on accounting process, budgeting, audit, and any needed verbiage changes for new contracts
- Communicate changes to CFO, board, senior staff, key program managers, auditors, banks, etc.
- Determine requirements to retrospectively adopt the new standard

Sources and Additional Resources

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- FASB Codification: FASB ASC 606
- AICPA Audit Risk Alert - Not-For-Profit Entities Industry Developments-2018
- AICPA Audit and Accounting Guide - Revenue Recognition (Chapter 8 specific to NFPs)
- AICPA Audit and Accounting Guide – Not-for-Profit Entities (Appendix B specific to ASC 606)
- FASB Exposure Draft: Not-for-Profit Entities (Topic 958) – *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

Questions

Thank you for your attention!