



Nonprofit Revenue Recognition: The New Rules

There are two new generally accepted accounting principles (GAAP) standards around revenue: FASB ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606) and FASB ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. These are both effective for annual periods beginning after December 15, 2018 (calendar year 2019, fiscal year 2019-2020). Because these represent changes to GAAP, they may change how you record grants and other revenue and how you word future contracts. This article covers three key areas of the new standards: 1) exchange vs. nonexchange transactions; 2) exchange transaction guidance; and 3) grants and contributions (nonexchange transaction) guidance.

So when should the revenue be recorded?



Exchange vs. Nonexchange Transaction

The appropriate accounting for revenue depends on whether the transaction represents earned income (exchange), contributory income (nonexchange) or a combination of the two. Typical nonprofit exchange transactions include tuition, ticket sales, program service fees, and rental income. While individual contributions are nonexchange transactions, the proper treatment of grants and contracts depends on the purpose and terms of the underlying agreement. Membership dues and sponsorships may be exchange and/or nonexchange, depending on the nature and amount of benefits received. To determine the proper revenue recognition, read the underlying agreement, and ask the following: Is direct commensurate value provided to the resource provider? If yes, it is an exchange transaction; if no, it is a nonexchange transaction.

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Commensurate value means corresponding in amount, magnitude or degree. If you provide an organization \$100 and receive goods, services or other benefits equal to \$100,

then you have received commensurate value for your payment.

The **resource provider** is the one paying the organization. Two key considerations: 1) furthering a resource provider's mission does not constitute commensurate value; and 2) a benefit received by the general public does not constitute commensurate value. For example, if a local government provides funds to a nonprofit to operate a community center, the primary beneficiary is the general public. This is considered an indirect societal benefit, not one of direct equal value, and, therefore, the government has not received commensurate value.

Other factors that help determine whether a transaction is exchange or nonexchange include:

- **Intent:** If the express intent by both parties is to exchange resources for goods or services of commensurate value, it should be treated as an exchange transaction.
- **Control:** If the resource provider determines payment, this may indicate a nonexchange transaction. If the total payment is based on the quantity of goods/

services to be received, and all parties agree on the commensurate value, this may indicate an exchange transaction.

- **Rights:** If something is produced as a result of the agreement and the resource provider retains the rights to it, this may indicate an exchange transaction.
- **Penalties:** If the resource provider assesses penalties for noncompliance, this may indicate an exchange transaction.

Exchange Transaction Guidance

The new standard *Revenue from Contracts with Customers* provides a 5-step revenue model for recognizing exchange transactions:

1. Identify the contract with the customer. A contract is an agreement (written or otherwise) that creates enforceable rights and obligations, and exists if the following conditions are met: a) all parties have approved the contract; b) each party's rights regarding the goods or services are identified; c) payment terms are identified; d) the contract has commercial substance; and e) collection is probable (whether directly from the customer, or someone paying on the customer's behalf).
2. Identify the separate performance obligations in the contract. A performance obligation is an entity's promise to transfer a good or service. Each performance obligation is either distinct or a series of goods/services that are substantially the same; the customer must be able to benefit from the goods/service on its own to be a separate obligation.
3. Determine the transaction price based on the commensurate value of the goods/services provided.
4. Allocate the transaction price to each of the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation. For example, revenue for a one-day seminar would be recognized on the day of the seminar; however, tuition for a 12-month program

would be recognized evenly over the 12 months, as the education is provided.

Grants and Contribution (Nonexchange) Guidance

The 5-step revenue model does not apply to nonexchange transactions. Nonexchange transactions are recognized as revenue when received or when the pledge is made, unless the award is deemed to be conditional. Awards deemed to be conditional are recognized as revenue when the barrier is overcome. The existence of donor-imposed restrictions does not change when the revenue is recognized. Note that this is not new guidance; this is the existing revenue recognition rule for contributions. What has changed with the new standard *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* is clarification on when a contribution is considered conditional.

Conditional Awards

Two conditions must be present for a nonexchange transaction to be conditional: 1) a right of return or release must exist; AND 2) the agreement must include a barrier.

1. A **right of return/right of release** means that if certain terms and conditions aren't met, the organization has to give back any funds received, or the grantor can cancel the award and not provide the funding.
2. A **barrier** is something that must be overcome before the organization is entitled to receive the funds. Factors that may indicate a barrier:
 - a. Inclusion of measurable performance-related criteria such as: a specified level of service, output or outcome; a matching requirement; or an outside event beyond the entity's control.
 - b. Limited discretion by the recipient on the conduct of an activity such as: specific guidelines covering qualifying expenses; or requirements to hire certain individuals to be involved.
 - c. The extent to which a stipulation is related to the purpose of an agreement. Stipulations that are

not related to the purpose of an agreement such as producing an annual report or obtaining an audit are not indicative of a barrier.

- d. A probability assessment about whether the recipient is likely to meet the barrier is not a factor when determining whether a barrier exists. There either is, or isn't, a barrier; your likelihood to meet it doesn't matter.

A barrier of limited discretion by the recipient on the conduct of an activity represents the most significant clarification in the new standard. It is common for federal and other government awards to include specific guidance on qualifying expenses (such as following cost principles under the Uniform Grant Guidance); often such agreements are paid on a cost-reimbursement basis. As a result, many government awards will now be treated as conditional nonexchange transactions. In the past, these were often treated as exchange transactions (recognize revenue as the costs are incurred).

Donor Restrictions

Donor restrictions indicate how broad or narrow the purpose of the agreement is and whether the funds can be used only after or within a specified date. While donor-imposed restrictions limit the use of the contribution, they do not affect whether the recipient is entitled to the contribution. This is different from a condition which means there is a barrier that must be met before you are entitled to the funds.

Here is an example of what a statement of activities looks like under both options:

| | SIMULTANEOUS RELEASE OPTION | | | ALL RESTRICTED OPTION | | |
|---------------------------------------|-----------------------------|-------------------------|--------------|----------------------------|-------------------------|--------------|
| | Without Donor Restrictions | With Donor Restrictions | Total | Without Donor Restrictions | With Donor Restrictions | Total |
| SUPPORT AND REVENUE | | | | | | |
| Government grants | \$ 2,275,128 | \$ - | \$ 2,275,128 | \$ - | \$ 2,275,128 | \$ 2,275,128 |
| Foundation grants | 227,500 | 650,000 | 877,500 | 227,500 | 650,000 | 877,500 |
| Individual contributions | 312,586 | 52,687 | 365,273 | 312,586 | 52,687 | 365,273 |
| Special events, net | 281,679 | - | 281,679 | 281,679 | - | 281,679 |
| Investment return | 16,578 | - | 16,578 | 16,578 | - | 16,578 |
| Other | 4,878 | - | 4,878 | 4,878 | - | 4,878 |
| | 3,118,349 | 702,687 | 3,821,036 | 843,221 | 2,977,815 | 3,821,036 |
| Net assets released from restrictions | | | | | | |
| Satisfaction of purpose restriction | 282,444 | (282,444) | - | 2,557,572 | (2,557,572) | - |
| Satisfaction of time restriction | 125,000 | (125,000) | - | 125,000 | (125,000) | - |
| Total support and revenue | 3,525,793 | 295,243 | 3,821,036 | 3,525,793 | 295,243 | 3,821,036 |

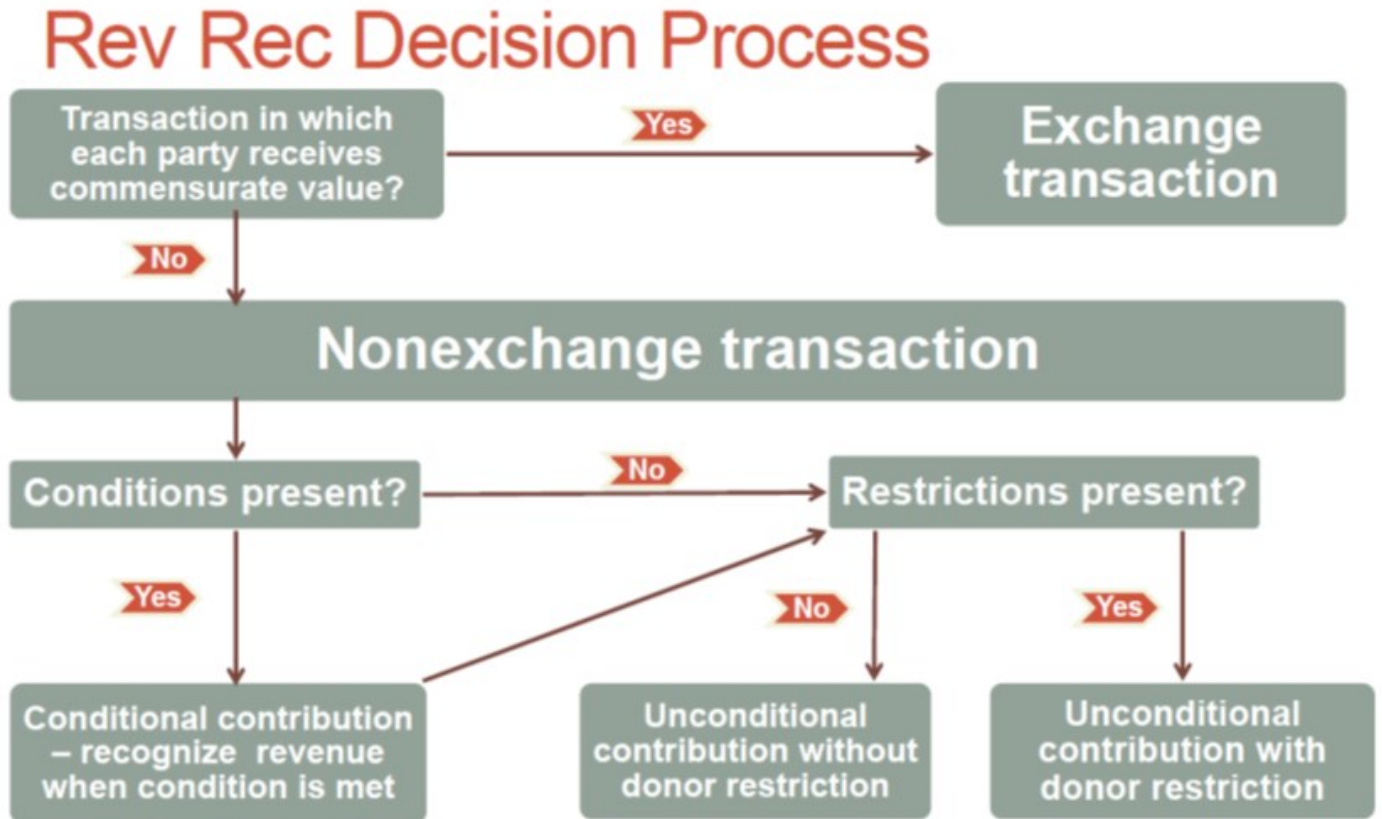
A conditional grant may also be restricted. This can potentially make the accounting more complex, especially if you have significant government grants that used to be treated as exchange transactions without donor restriction but that are now conditional and with donor restriction. The new standard has a provision to make this easier: the simultaneous release option.

Nonprofit organizations have an option to report restricted contributions as unrestricted if the restricted purpose is met in the same reporting period. If you use this option, the impact is the restricted activity generally relates to future activity only. If you don't have this policy, then all restricted contributions are recorded as restricted, and then released to unrestricted as the specified purpose has been met or time period passed. For example: an individual gives an organization \$50 for its youth backpack program. While it is restricted, it will be used in the year it is donated. Under the simultaneous release option, the organization would show this as unrestricted. Otherwise, the \$50 is treated as a restricted contribution, with a corresponding release to unrestricted in the same year.

This used to be an all-or-nothing policy – you had it, or you didn't. Under the new guidance, nonprofits now have the option to apply the policy to one of two buckets: 1) conditional with donor-restricted contributions; and/or 2) unconditional with donor-restricted contributions. When selected for either (or both) buckets, this treatment needs to be applied consistently from year to year and adequately disclosed in the financial statements.

Revenue Recognition Process

Here is a decision tree for the revenue recognition process:



For more information of recording restricted contributions in QuickBooks, read our article [HERE](#).