FASB'S ASU 2018-08 IMPACTS NOT-FOR-PROFIT ORGANIZATIONS

By Jimmy Mo

A new pronouncement from the Financial Accounting Standards Board (FASB) is expected to have a profound impact on the way NFPs recognize grant revenues and report them in their financial statements.

Whether received from governmental agencies, private foundations, or other types of entities, the resources provided by grants have always been an essential revenue source for not-for-profit organizations (NFPs). For example, according to those enterprises that track government spending, the federal government obligated approximately $4.5 trillion in grants and fixed charges to organizations during the fiscal year ended 9/30/17. Likewise, private foundations gave approximately $63 billion to organizations during 2015. Given such significant dollar amounts, it is clear that the revenues received from the governmental and private sectors have an enormous impact on the not-for-profit industry.

In June 2018, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made. This new pronouncement is expected to have a profound impact on the way NFPs recognize grant revenues and report them in their financial statements. However, while the focus of this article is on NFPs, as noted in various comments below, ASU 2018-08 is also applicable to those for-profit entities (or otherwise commonly referred to as "business entities," which can be public or private) that have grants and donations as part of their operations.

Overview

When an NFP receives (1) cash, (2) other types of assets, or (3) services provided by individuals, business entities, other NFPs, or governmental agencies, the NFP records such inflows of resources as one of three types of transactions: contributions, exchange transactions, or agency transactions.

The FASB defines a contribution as "an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner." Accordingly, an NFP recognizes contributions as revenues when they are received or are unconditionally promised, with contributions being typically recorded at their fair values at the dates of receipt.

An exchange transaction, by contrast, is defined by the FASB as "a reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other assets or services or incurring other obligations." Thus, an NFP that receives funds in an exchange transaction records revenues when it has met its obligation for the revenue. At times, revenue recorded by an NFP for an exchange transaction is commensurate with the expenses that it incurs for that revenue. In addition, while accounting and reporting can be significantly different between business entities and not-for-profit entities, it is important to note that the recognition and measurement principles for exchange transactions are essentially the same for both NFPs and for-profit enterprises.

As for agency transactions, the FASB defines these as "a type of exchange transaction in which the reporting entity acts as an agent, trustee, or intermediary for another party that may be a donor or donee". Therefore, an NFP that receives funds as an agency transaction does not recognize revenue from this type of transaction, but instead records an asset and an offsetting liability, since the NFP is, in effect, acting as a go-between for the resource-provider and the recipient of those funds.

Recording Grants

There has always been some diversity in practice in how NFPs record grants, since grants can be characterized either as exchange or agency transactions or as contributions, depending on the terms of the underlying grant agreements. As a very general rule, grants received from governmental agencies may have been recorded as exchange transactions, because the recipient NFPs believe it was performing services for the government in return for the resources received; by contrast, grants received from private foundations and others are typically recorded as contributions, to be used as requested by the grantors or as the NFP chooses, depending on the grant's terms. Further, for cost-reimbursement grants, NFPs record grant revenues in direct relation to the extent that grant-related expenses are incurred, resulting in a net-zero impact.

There has been an unwritten rule that NFPs who receive grants from governmental agencies are providing a service on behalf of the governmental agencies and, therefore, providing a reciprocal transaction when performing those services stipulated in the grants to a third party or the general public. This has always been the rationale for recording governmental grants as exchange transactions.

Effective for reporting periods beginning after 12/15/18, nonpublic entities will be required to recognize revenue from an exchange transaction in accordance with FASB Accounting Standards Codification 606. Contributions are recognized in accordance with ASC 958.

In cases when a transaction has been determined to be a contribution, it can also sometimes be difficult to determine whether or not the contribution is "conditional." In other words, donors may add stipulations to a contribution (but fail to state what the consequence will be if the donees fail to meet those stipulations). Under current standards, a contribution is considered to be unconditional if the possibility that the condition will not be met is "remote," which can be difficult to define. Since contributions should only be recognized as revenue when they are unconditionally promised, the determination of what qualifies as remote can affect the timing of when contributions are recognized as revenue.

Content of ASU 2018-08

In an effort to decrease the diversity in practice in how entities record grants, the FASB issued ASU 2018-08 to clarify the factors and criteria to be considered when determining whether (1) a transaction should be characterized as an exchange transaction or as a contribution, and (2) a contribution is, or is not, conditional.

Distinguishing between an exchange transaction and a contribution.

ASU 2018-08 amends the guidance an NFP will use to determine whether a resource-provider is participating in an exchange transaction with the NFP by stating that:

1. A resource-provider is not synonymous with the general public. A benefit received by the public as a result of the assets transferred is not comparable to commensurate value received by the resource-provider.

2. Execution of the resource-provider's mission, or the positive sentiment from acting as a donor, does not equate to commensurate value received by a resource-provider.

The amendments in ASU 2018-08 clarify that, consistent with current accounting standards, in instances in which a resource-provider is not itself receiving commensurate value for the resources provided, it must be determined whether a transfer of assets instead represents a payment from a third-party payer on behalf of an existing exchange transaction between the recipient and an identified customer. If so, other accounting guidance would apply.

Determining whether a contribution is conditional.

ASU 2018-08 requires that an entity determine whether or not a contribution is conditional on the basis of whether or not the underlying agreement includes (1) a "barrier" that must be overcome, AND (2) either a right of return of the assets transferred or a right of release of the donor's obligation to transfer assets. The presence of both of these elements would represent a condition for the contribution.

The standard applies to all entities (including NFPs and business entities) that receive or make contributions of cash or other assets. The terms used in the financial statements to identify the revenue, such as government contracts, grants, or contributions, is not a factor in determining the applicability of this guidance.

ASU 2018-08 provides some indicators to assist in determining whether or not a stipulation in an agreement is considered to be a barrier for accounting purposes. These indicators include (but are not limited to) the following:

1. The inclusion of a measurable performance-related barrier or other measurable obstacle. Examples include achieving a certain level of service, an identified number of units of output, a specific outcome, or a matching requirement.

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2. The extent to which a stipulation limits discretion by the recipient on the conduct of an activity. Examples of limited discretion could include a requirement to follow specific guidelines about qualifying allowable expenses, a requirement to hire specific individuals as part of the workforce conducting the activity, or a specific protocol to which they must adhere.

3. Whether a stipulation is related to the purpose of the agreement. Administrative tasks, such as providing audited financial statements to the donor or other trivial stipulations, are not considered to be barriers.

Effective Date

ASU 2018-08 is effective as follows:

For resource-recipients:

1. Public business entities or NFPs that have issued-or are conduit bond obligors for-securities that are traded, listed, or quoted on an exchange or an over-the-counter market should apply the amendments in ASU 2018-08 on contributions received for annual periods beginning after 6/15/18, including interim periods within those annual periods.

2. All other entities should apply the amendments in ASU 2018-08 for transactions for annual periods beginning after 12/15/18, and interim periods within annual periods beginning after 12/15/19.

For resource-providers:

1. Public business entities or NFPs that have issued-or are a conduit bond obligor for-securities that are traded, listed, or quoted on an exchange or on an over-the-counter market should apply the amendments in ASU 2018-08 for contributions made for annual periods beginning after 12/15/18, including interim periods within those annual periods.

2. All other entities should apply the amendments in ASU 2018-08 for transactions for annual periods beginning after 12/15/19, and interim periods within annual periods beginning after 12/15/20.

When adopting ASU 2018-08, entities should apply the amendments on a modified prospective basis, which requires application to all agreements that have not been completed as of the effective date and those that are entered into after the effective date. In addition, entities should not restate any prior-period amounts that were recognized. Early adoption of ASU 2018-08 is permitted, as is retroactive application.

Applications of ASU 2018-08

Example 1.

During the year ended 6/30/18, NFP A obtains a one-year cost-reimbursement grant from a governmental agency. The details of the grant are as follows:

- Grant period: 3/1/18 to 2/28/19
- Purpose: to tutor children in grades 9-12
- Payment method: cost reimbursement
- Grant budget: $1 million
- NFP A is required to spend only the funds on allowable expenses in accordance with the governmental agency's allowable expenses guidelines. Any unused assets are forfeited, and any unallowed expenses that have been paid by the governmental agency are required to be refunded.

In fiscal-years 2018 and 2019, NFP A incurred $300,000 and $700,000, respectively, in grant-related allowable expenses.

Under current accounting standards, NFP A would most likely recognize the proceeds from this grant as revenue from an exchange transaction.

NFP A would recognize $300,000 in grant revenue in fiscal-year 2018 because NFP A expended $300,000 in grant expenses. Likewise, NFP A would most likely recognize $700,000 in grant revenue in fiscal-year 2019 because NFP A expended $700,000 in grant expenses.

However, under the guidelines of ASU 2018-08, NFP A would need to treat this grant as a conditional contribution, since the grant contains a barrier (specifically, only using the grant funds on allowable expenses) and a right of release for any unused assets or the right of return for any unallowable expenses. NFP A would recognize revenue based on the amount of incurred allowable expenses in each year. Therefore, NFP A would recognize $300,000 and $700,000 in grant revenue in fiscal-years 2018 and 2019, respectively.

For this example, there would be no effect of ASU 2018-08 on the amounts of revenue recognition in the financial statements. NFP A would simply account for the grant as an exchange transaction under the current accounting standards and as a contribution under ASU 2018-08.

Example 2.

Same details as the grant noted in Example 1 above, except that the governmental agency has a right of release, as described below:

- Grant period: 3/1/18 to 2/28/19
- Purpose: to tutor 1,000 children in grades 9-12
- Payment method: cost reimbursement
- Grant budget: $1 million
- The governmental agency has a right of release from the obligation of paying the grant prorated for any children who are not tutored.

In fiscal-year 2018, NFP A tutored 250 children and incurred $300,000 in grant-related expenses. In fiscal-year 2019, NFP A tutored 750 children and incurred $700,000 in grant-related expenses.

Under current accounting standards, NFP A would most likely recognize the revenue for this grant the same manner as it did for Example 1. Based on the amount of grant expenses incurred, NFP A would recognize $300,000 and $700,000 in grant revenue in fiscal-years 2018 and 2019, respectively.

However, under ASU 2018-08, NFP A would need to treat this grant as a conditional contribution since the grant contains a barrier (specifically, the number of children to be tutored) and a right of release for any children that NFP A does not tutor. Accordingly, NFP A would recognize revenue prorated for the number of children tutored each year. Thus, as a result, NFP A would recognize $250,000 (250 children tutored / 1,000 total children * $1,000,000) in grant revenue in fiscal-year 2018 and $750,000 (750 children tutored / 1,000 total children * $1,000,000) in grant revenue in fiscal-year 2019.

Under current accounting standards, NFP A would not have a net gain or net income related to this grant since revenue would equal expenses. However, under ASU 2018-08, NFP A would recognize a net loss of $50,000 ($250,000 revenue less $300,000 expenses) in fiscal-year 2018 and a net gain of $50,000 ($750,000 revenue less $700,000 revenue) in fiscal-year 2019 related to this grant.

Example 3.

During the year ended 12/31/2018, NFP B receives a $600,000 three-year grant from a private foundation to provide general operating support for NFP B's mission. The grant is to be paid evenly throughout the three years (or $200,000 each year). The grant stipulates that the private foundation will provide Year One's payment upon both parties' signing the grant agreement and will provide the payments for Year Two and Year Three subject to NFP B's providing a progress report on its activities by the first day of both Year Two and Year Three.

Under current accounting standards, NFP B may consider the progress reports to be a condition of the grant. Therefore, NFP B would recognize the revenue associated with Year Two and Year Three ($200,000 in each year) when NFP B provides the foundation with the annual progress report.

Under ASU 2018-08, by contrast, NFP B would recognize all of the revenue ($600,000) from the private foundation's grant in Year One because the annual progress report would be considered to be an administrative process; accordingly, there would be no barrier to the grant and no right of return.

Analysis.

The three preceding examples are just a sample of the ways in which ASU 2018-08 could have a significant effect on NFPs, particularly those that receive grants from entities in both the governmental and private sectors.

While the amount of grant revenue remained unchanged under the provisions of current accounting standards and ASU 2018-08 in Example 1, the standards NFP A uses to recognize the revenue will nonetheless be subject to different timing and disclosure requirements.

In the case of Example 2, readers of the financial statements of NFP A would typically expect the organization to be at a "breakeven" point in terms of grant revenue and expense. However, under ASU 2018-08, NFP A would recognize expenses and revenues in different years.

For Example 3, NFP B may have preferred to record the grant revenue evenly during the three-year period to make it align with related expenses. However, under ASU 2018-08, NFP B would be required to recognize all of the revenue in Year One, offset by only that year's grant-related expenses, but would have to continue to recognize the grant-related expenses in Year Two and Year Three without any revenue to offset those expenses.

The seeming contradiction of not having revenue and the related expenses recognized in the same year in Examples 2 and 3 may make it difficult for some readers of NFP financial statements to determine the true financial health of the organization. As a result, for example, lenders may make incorrect decisions as to whether to provide loans to NFPs or may provide less favorable financial terms, even though there were really no operational changes at the NFP. Likewise, grantors and donors may choose to fund or contribute to different NFPs, and NFP governing boards and managements may make incorrect stewardship decisions, even though there would not be an impact on operating cash flows or on the viability of the organization.

Conclusion

For the most part, NFPs have been recognizing grants and contributions in the same manner for decades. ASU 2018-08 will change revenue-recognition considerations for these types of funding, particularly for revenue related to governmental grants. However, ASU 2018-08 now ensures that the organization's management will need to review each grant individually, to identify the underlying conditions and responsibilities, and to assess the impact of the timing for recognition of the related revenue. This task will require a change in institutional mind-set, and may be time-consuming for those organizations with large grant portfolios.

Therefore, educating the users of an NFP's financial statements before the adoption of ASU 2018-08 is vital. Just like other upcoming accounting standards that will impact revenue recognition and the accounting and reporting for leases, those involved with NFPs of all types need to be informed about the implications of ASU 2018-08 as soon as possible.