Part 2

Nonprofit grant accounting with the new revenue recognition model

By Diana Luttmann, CPA

New guidance issued in June will help not-for-profit entities account for grants and contracts under the new revenue recognition principles. This article addresses details and effective dates for the changes.

The new revenue recognition principles included in the financial accounting standards update ASU 2014–09, *Revenue from Contracts with Customers (Topic 606)*, is a convergence of the U.S. Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS). The new model is established to clarify and unify the two sets of principles to improve the quality of revenue reporting of transactions with customers. The basic idea of the new standards is that recognized revenue should match the benefit being provided.

ASU 2014–09 resulted in questions from non-profit entities about the treatment of grants received from governments, foundations or similar contracts. To address these concerns, on June 21, 2018, FASB issued ASU 2018–08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, the goal of which is to help entities determine reciprocal and nonreciprocal transactions and clarify areas within the current codification.

For contributions received, an entity would follow Subtopic 958–605, which will be renamed *Not-for-Profit Entities—Revenue Recognition—Contributions* upon the effective date of ASU 2014–09, while for exchange transactions an entity would follow Topic 606, *Revenue from Contracts with Customers*.

Clarification of terms

To determine if a transaction is a contribution or an exchange transaction, the entity must determine if the resource provider (for example, a government) receives equal value in return for what the resource provider pays (the grant). The guidance clarifies that when the general public is the recipient of the services or goods, the transaction is not considered a reciprocal transaction with the resource provider; it's a contribution. If the resource provider is acting as a third-party payer (such as payments under Medicare and Medicaid programs, Pell grants or government tuition assistance programs), the third-party payer is considered to be acting on behalf of the service recipient in an exchange transaction that already exists. When a third-party payer is involved with these types of exchange transactions, the entity would need to follow Topic 606.

An entity must determine if a contribution is conditional. A contribution is conditional if it has both a barrier that must be overcome and an agreement requiring advance payment to be returned or future payment not to be obligated whence that barrier is not overcome. Barriers might include measurable performance requirements, matching requirements, specific use stipulations that expand further than a general activity or timeframe, or stipulations about the purpose of the agreement, such as serving a certain number of units or program deliverables. Conditional contributions are not contracts that include standard language referring to return of funds but without a specified barrier to overcome. After a condition is met, there could be additional donor-imposed restrictions.

Based on the current varying practice of accounting for grants and contributions, it is expected that the clarified guidance will result in more grants being considered contributions and more contributions being considered conditional. The standards acknowledge that there are differences in practice about the naming of grants, contributions and membership dues, and require that the accounting treatment be indicative of the substance of each transaction rather than determined by labels used.

The guidance offers no requirement for renaming or using specific labels for different revenue types. However, it is

necessary for the entity to consider that each revenue source could include either or both contributions and exchange categories. The standards should be applied to agreements that are not completed as of the effective date or that are entered into after the effective date. The standards should not be used to change reporting of revenue and expenses that have been recognized before the effective date. Because of this prospective approach, there will be no prior-period restatement or cumulative effect change in net assets. However, the entity should disclose the nature of and reason for the accounting change and also the impact of the accounting change to each line item that is affected by the new guidance.

Effective dates

The effective date differs for entities that are resource recipients and resource providers. The annual reporting period effective dates for *resource recipients* are for periods beginning after June 15, 2018, for public business entities or a nonprofit that issued—or is a conduit bond obligor for—securities that are traded, listed or quoted on an exchange or an over-the-counter market; and periods beginning after Dec. 15, 2018, for all other resource recipients.

The annual reporting period effective dates for *resource providers* are for periods beginning after Dec. 15, 2018, for public business entities or a nonprofit that has issued—or is a conduit bond obligor for—securities that are traded, listed or quoted on an exchange or an over-the-counter market; and periods beginning after Dec. 15, 2019, for all other resource providers.

Part 2 Conclusion

The clarified language and examples within the amendments to the codification under *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made* are very useful in determining appropriate reporting of grants and contracts. In practice, the amendments will help accountants consistently report grants as either exchange or contribution transactions. Both conditional contributions and exchange transactions require financial statement disclosures; however, it is expected that disclosures for conditional contributions would take less effort than disclosures under Topic 606. Grants for the benefit of the public are contributions in nature, and this alignment will result in more consistent reporting.

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