

Changes to accounting for grants and contributions made and received

Prepared by:

Susan L. Davis, Partner, National Professional Standards Group, RSM US LLP
susanl.davis@rsmus.com, +1 515 281 9275

Tom Sneeringer, Partner, RSM US LLP
tom.sneeringer@rsmus.com, +1 301 296 3642

August 2018

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Introduction

In June 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU clarifies the guidance presented in Topic 958, “Not-for-Profit Entities,” of the FASB’s Accounting Standards Codification (ASC) for evaluating whether a transaction is reciprocal (i.e., an exchange transaction) or nonreciprocal (i.e., a contribution) and for distinguishing between conditional and unconditional contributions. The purpose of this paper is to provide an overview of the clarifications made by the ASU, as well as an overview of its effective dates and transition provisions.

Effective dates and transition

The following effective dates for ASU 2018-18 are rapidly approaching for certain entities:

- For entities that are public business entities (PBEs), and for not-for-profits (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 (public NFPs), that are:
 - *Resource recipients*: The ASU is applicable to contributions received for annual periods beginning after June 15, 2018, including interim periods therein.
 - *Resource providers*: The ASU is applicable to contributions made for annual periods beginning after December 15, 2018, including interim periods therein.
- For all other *resource recipients*, the ASU is applicable to contributions received for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.
- For all other *resource providers*, the ASU is applicable to contributions made for annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020.
- Early adoption is permitted.

The FASB provided the fast-approaching effective dates for resource recipients to make them as consistent as possible with the effective dates of ASC 606, “Revenue from Contracts with Customers.”

The ASU may be adopted using either: (a) the modified prospective basis, with no restatement of opening net assets or equity or (b) the full retrospective method. Under the modified prospective basis, the ASU is applied to agreements that are:

- Not completed as of the effective date, with the ASU’s guidance applied only to the portion of revenue or expense not yet recognized (i.e., not recognized before the effective date).
- Entered into after the effective date.

A completed agreement is an agreement for which all of the revenue (resource recipient) or all of the expense (resource provider) has been recognized before the effective date of the ASU based on the guidance in place before that effective date (e.g., ASC 605, “Revenue Recognition,” ASC 958-605, “Not-for-Profit Entities – Revenue Recognition”).

If the modified prospective basis is elected, the financial statements should disclose:

- The nature and the reason for the change.
- The reasons for significant changes in financial statement line items resulting from the changes made by the ASU.

Purpose and applicability

The purpose of the ASU is two-fold:

1. To provide more clarity for evaluating if a transaction is reciprocal (an exchange transaction primarily under ASC 606) or nonreciprocal (a contribution under ASC 958-605).
2. To support the evaluation of whether a contribution is conditional or unconditional, including discussion on distinguishing a condition from a restriction.

The ASU applies to all entities that make or receive contributions of cash or other assets, not just to NFP entities. It does *not* apply to the transfer of assets from government entities to business entities.

Key changes that may impact whether a grant is considered an exchange transaction or contribution

During the exposure draft period for the ASU, materials provided by the FASB included an expectation that many grants currently reported as exchange transactions would be classified as contributions under the then-proposed guidance. This is because the then-proposed guidance: (a) would make changes to the definition of a contribution and an exchange transaction and (b) would provide clarification on several issues for which there has been diversity in practice. We believe the same is true about the finalized guidance in the ASU. Provided in the table that follows are the definitions of a contribution and an exchange transaction before and after ASU 2018-08:

Definition of contribution (and exchange transaction) in the Master Glossary of the ASC	
Before ASU 2018-08	After ASU 2018-08
<p>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. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value; from investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners; and from other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers. In a contribution transaction, the value, if any, returned to the resource provider is incidental to potential public benefits. In an exchange transaction, the potential public benefits are secondary to the potential proprietary benefits to the resource provider. The term <i>contribution revenue</i> is used to apply to transactions that are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains). See also Inherent Contribution.</p>	<p>An unconditional transfer of cash or other assets, as well as unconditional promises to give, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from:</p> <ol style="list-style-type: none"> a. Exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately commensurate value b. Investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners c. Other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers. <p>In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit although that benefit is not considered to be of commensurate value. In an exchange transaction, the potential public benefits are secondary to the potential direct benefits to the resource provider. The term <i>contribution revenue</i> is used to apply to transactions that</p>

	are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains). See also Inherent Contribution and Conditional Contribution.
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The clarifications provided in the ASU to address the diversity that developed when the old definitions were applied in practice include the following:

- A resource provider *including a foundation, government agency, corporation or other entity* is not synonymous with the general public.
- Commensurate value to the resource provider (which is required for an exchange transaction), as a result of assets transferred, does not occur when the benefit is received by the general public.
- Execution of the resource provider's mission, or the donor receiving *positive sentiment*, does not constitute commensurate value for purposes of evaluating whether the resource recipient should account for the resources received as an exchange transaction or contribution.
- In accordance with existing standards, when the transfer of assets represents a third-party payment on behalf of an existing exchange transaction between a recipient and an identified customer, other guidance applies (such as ASC 606). Examples would include tuition, Medicare and Medicaid payments.

Key changes that may impact the timing of recognizing contributions received as revenue

Prior to adoption of the ASU, ASC 958-605 provides for a *probability or likelihood* assessment related to conditions, which allows for immediate recognition of a contribution when it is deemed unlikely that conditions will not be met. An example of a contribution that would be immediately recognized prior to adoption of the ASU includes funding received annually with a condition that: (a) the organization has never failed to meet and (b) the organization concludes they will meet in the current year.

The ASU precludes the use of a *probability or likelihood* assessment related to conditions. Recognizing contributions received as revenue is not permitted until the condition is met, regardless of any historical outcomes related to previous agreements or expectations related to continuing or new agreements. As a result, conditional contributions received are recorded as a liability until the condition is met, and conditional contributions promised, but not yet received, are not recognized until the condition is met.

Existing disclosure requirements for conditional contributions at ASC 958-310-50-4 continue to apply.

Conditions, barriers and restrictions

When an agreement contains a condition that has not been met, recognition of the contribution is precluded until the condition has been met. Conditions exist when an agreement includes a performance-related barrier that must be overcome *and* at least one of the following:

- A right of return of assets transferred.
- A right of release of a promisor's obligation to transfer assets.

A performance-related barrier represents something that must be achieved, performed or delivered by the intended resource recipient in order to receive funds under the agreement and must both:

- Be determinable from the agreement or a document referenced in the agreement.
- Result from clear communication that the recipient is not entitled to assets transferred or promised to be transferred unless the barrier is overcome.

As explained further in ASC 958-605-25-5E, when an agreement contains *ambiguous* stipulations that are not clearly unconditional, the agreement is presumed to contain conditions.

As a matter of policy, some resource providers include a right of return and (or) a right of release from obligation clause in their contracts, which is sometimes referred to as a subjective termination clause. Such clauses are intended to protect the resource provider in the event of unexpected changes, such as turnover in the recipient’s key leadership positions. As explained further in ASC 958-605-55-17B, when such clauses do not also include a measurable performance-related barrier, the agreement should be considered unconditional.

The ASU included the following table at ASC 958-605-25-5D to provide additional guidance on identifying barriers.

Indicates a Barrier	
Measurable Performance-Related Barrier or Other Measurable Barrier	<p>The agreement includes a measurable performance-related barrier or other measurable barrier.</p> <p>Measurable performance-related barriers or other measurable barriers often are coupled with a time limitation (for example, indicating that the outcomes are to be achieved within a specified time frame).</p> <p>Examples of measurable performance-related barriers include a requirement that indicates that a recipient’s entitlement to transferred assets is contingent upon the achievement of any of the following:</p> <ol style="list-style-type: none"> a. A specified level of service b. An identified number of units of output c. A specific outcome. <p>Other measurable barriers stipulate that a recipient is entitled to the resources if an identified event occurs (for example, a matching requirement).</p>
Limited Discretion by the Recipient on the Conduct of an Activity	<p>The recipient has limited discretion over the manner in which an activity can be conducted. Limited discretion of the recipient is more specific than a donor-imposed restriction. Restrictions limit the use of a contribution to a specific activity or time but do not necessarily place limitations on how the activity is performed. Examples of limited discretion could include a requirement to follow specific guidelines about incurring qualifying expenses, a requirement to hire specific individuals as part of the workforce conducting the activity (such as the hiring of specified employees or an identified professor at a university), and a specific protocol that must be adhered to.</p>
Stipulations That Are Related to the Purpose of the Agreement	<p>The stipulations are related to the purpose of the agreement. Examples could include a requirement for (a) a homeless shelter to provide a specified number of meals to the homeless (also an example of a measurable performance-related barrier), (b) an animal shelter to expand its facility to accommodate a specified number of additional animals, and (c) a research report that summarizes the findings from a grant on gluten-related allergies.</p> <p>A stipulation that is unrelated to the purpose of the agreement (for example, administrative and trivial stipulations) is not indicative of a barrier.</p> <p>Administrative and trivial stipulations could include routine reporting such as a requirement to provide (a) an annual report or (b) a report that summarizes the recipient’s performance to demonstrate the underlying actions that were taken to meet the barrier(s) specified in the agreement.</p> <p>For example, a report that indicates the number of meals that a homeless shelter provided to the homeless is typically not a stipulation that would contribute to</p>

Indicates a Barrier	
	achieving the purpose of the agreement. Rather, the action of providing a specified number of meals to the homeless would meet the stipulation that is required by a recipient to achieve the purpose of the agreement.

Barriers may sometimes be confused with restrictions. Note from the resource recipient flowchart provided on the next page that restrictions are evaluated *after* the presence of a barrier has been determined. Barriers *prevent access* to donor provided resources, while restrictions *place limitations on the use* of donor provided resources. Examples of restrictions include:

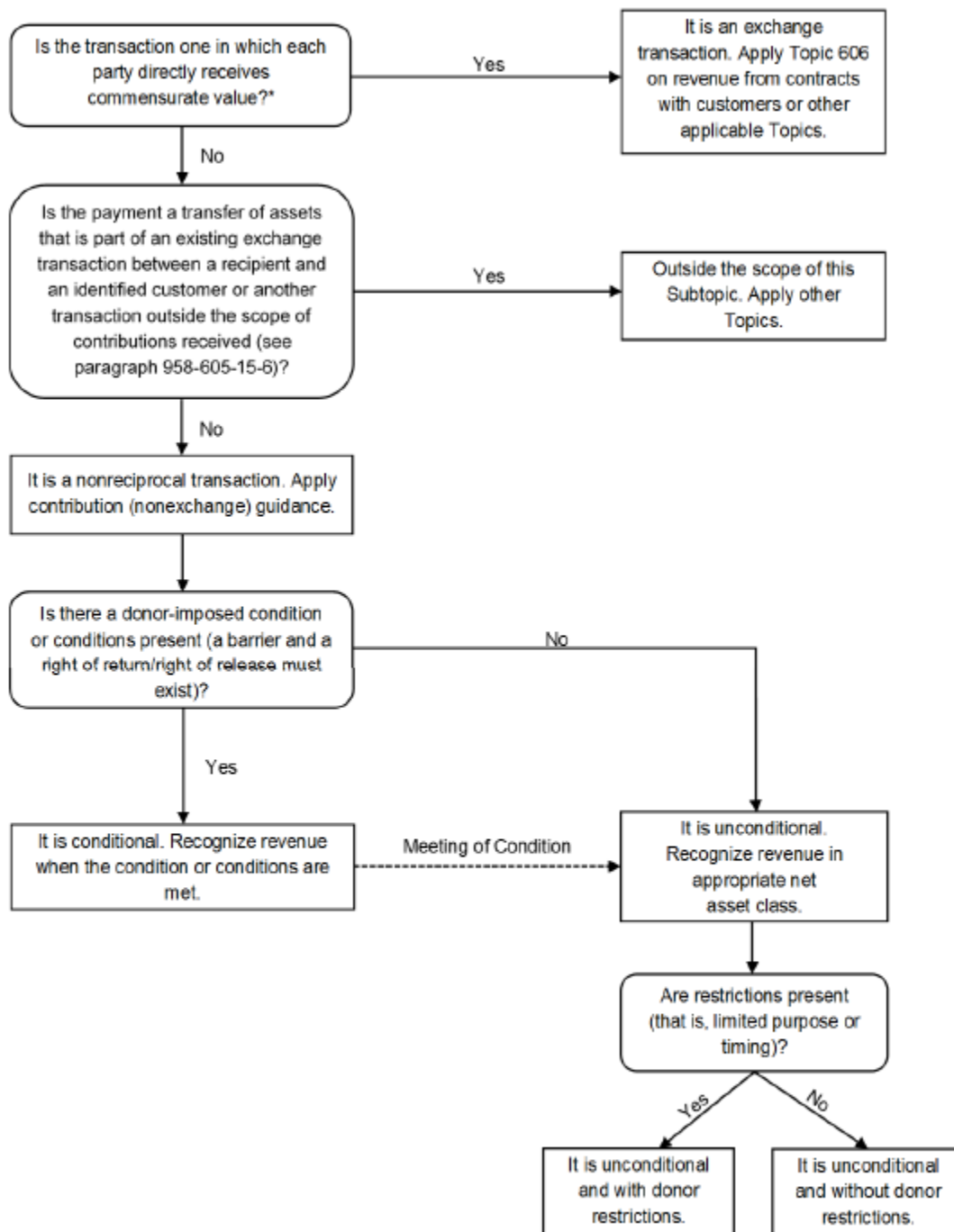
- An allowable use of resources (stated within the agreement) that is more narrow than the recipient’s mission.
- A permissible use of the resources by the recipient only after a specified date and (or) time.

The new examples provided in ASC 958-605-55-17E explain that limitations on how an activity is *conducted* represents a barrier; whereas, limitations on the use of resources to an activity that is more narrow than the resource recipient’s mission represent a restriction.

Evaluating the achievement of performance-related barriers may be more challenging for resource providers than for resource recipients. Resource recipients have historically had defined processes to measure compliance with agreements in order to receive funding and to match with accounting recordkeeping for release of restrictions. Resource providers have, in most cases, recorded grants made as expenses when approved and do not have systems organized to match their accounting with their recipients’ progress in meeting conditions. Resource providers often have highly developed processes or systems to monitor their recipients’ compliance with agreement stipulations; however, these systems do not generally provide accounting input other than to generate payment requests. The volume of activity related to the number of awardees, coupled with a great diversity in the barriers contained within a resource provider’s agreements, may provide a significant challenge in developing a monitoring system if one does not already exist. Because of this challenge, the FASB provided extended implementation time for resource providers (more so for resource providers that are not PBEs or public NFPs). During this period, we can expect to see resource providers revise agreements, where possible and prudent, to remove barriers, or to remove ambiguous language that would result in the assumption that barriers exist. Resource providers that continue to make conditional grants will need to update their monitoring systems to provide the accounting data needed to recognize when conditions are met, thereby triggering expense recognition.

Thought process for resource recipients

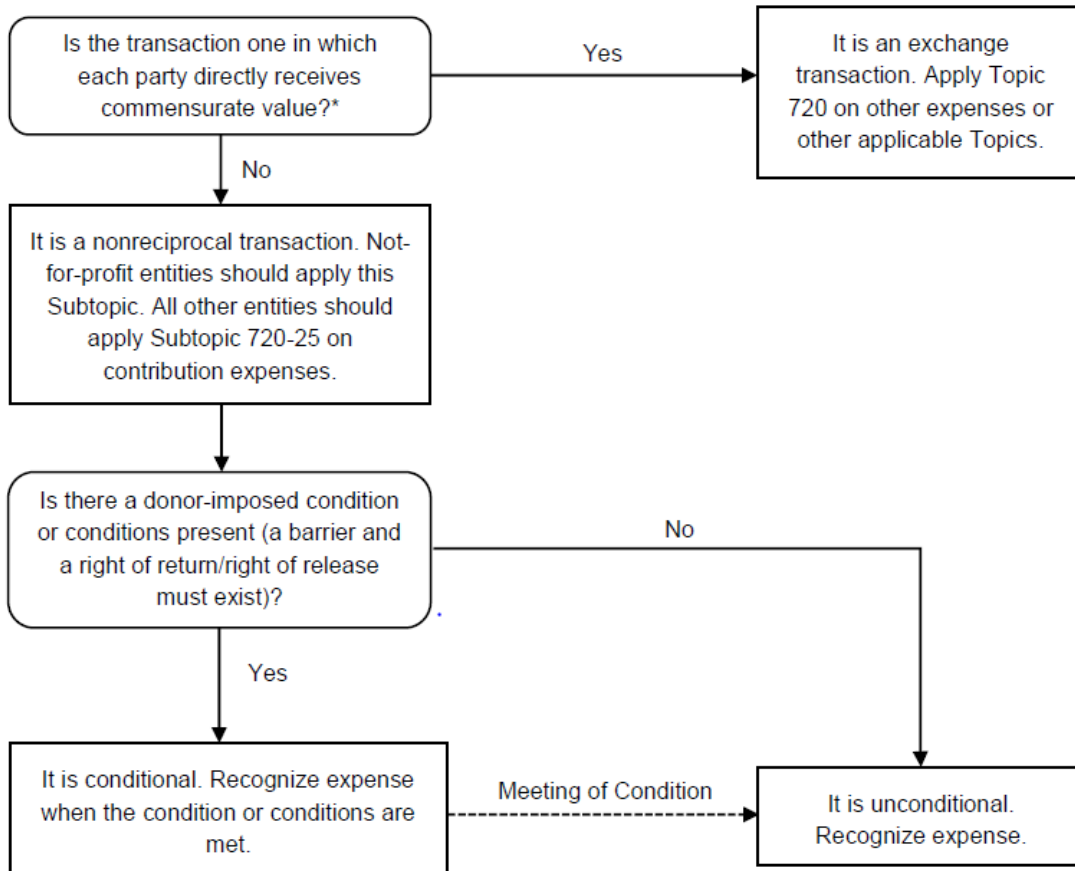
The ASU added the following key flowchart to ASC 958-605-55-1A, which outlines the thought process *resource recipients* should use to properly evaluate its transactions under ASC 958-605, as amended by ASU 2018-08.



*See paragraph 958-605-55-6 for guidance about transactions that are in part an exchange and in part a contribution.

Thought process for resource providers

As noted previously, the ASU applies to both resource providers and resource recipients. As such, the ASU also added the following key flowchart to ASC 958-720-55-1A, which outlines the thought process *resource providers* should use to properly evaluate its transactions under ASC 958-720, “Not-for-Profit Entities – Other Expenses” and ASC 720, “Other Expenses,” as amended by ASU 2018-08.



*See paragraph 958-605-55-6 for guidance about transactions that are in part an exchange and in part a contribution.

Summary

The foundational concepts with respect to commensurate value (which supports recording a transaction as an exchange transaction), barriers and conditions present both an opportunity and a challenge. ASU 2018-08 should result in less diversity in application of the relevant guidance in practice, resulting in consistency within the resource recipients’ industry, which benefits constituents relying on the financial statements of those recipients. The foundational concepts in ASU 2018-08 also provide clarity to resource providers and recipients alike for internally evaluating and accounting for resources provided or received. These benefits do not come without challenges.

The challenges arise from resource providers and recipients reacting to, and preparing for the implementation of, ASU 2018-08 in a short time frame. In addition, challenges arise in communicating with constituents if an organization finds it has an increase in conditional grants that in turn, has a short-

term impact on its operating statement. For resource providers, the challenge will be developing a monitoring system so that activity is recorded as expense in the proper period.

The over-arching challenge will be applying ASU 2018-08 in combination with a significant amount of other new guidance with near-term effective dates, including ASC 606 on revenue recognition, ASU 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, and ASC 842, "Leases." Having an action plan that moves your organization forward, with short-term periodic goals, benchmarks and self-assessments, will increase the likelihood of successfully navigating your journey from current to future state.

+1 800 274 3978
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