FASB ASU 2014-09 Revenue Recognition Standards for Nonprofit Entities: Implementing ASC 606 for NFPs

THURSDAY, DECEMBER 5, 2019, 1:00-2:50 pm Eastern

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Revenue Recognition Standards for Nonprofit Entities: Implementing Topic 606 for NFPs

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Mark Robins, CPA

Director, Nonprofit & Association Services Group

Mark Robins is a director in Aronson's Nonprofit & Association Services Group. Prior to focusing his specialization on nonprofit organizations, he spent time with the Employee Benefit Plan Services Group. Mark specializes in assurance and consulting services for foundations, public charities, schools and service organizations. His experience with fair value concepts, investment portfolios, federal compliance and revenue recognition issues allows him to be a valued resource for nonprofit organizations.

As an active participant in the accounting profession, Mark has taught several classes on financial reporting and auditing topics. He is also extensively involved in nonprofit accounting research to advance technical compliance and has contributed a number of blog posts to the Aronson nonprofit blog.

William Donahue, CPA

Senior Manager, Nonprofit & Association Services Group

As a senior manager in Aronson's Nonprofit Services Group, William Donahue, CPA, specializes in nonprofit clients. He works with a team of accountants to perform attestation services (audits, reviews, and compilations), providing assurance that an independent, objective audit has been performed completely in accordance with professional standards. Before joining Aronson, Will worked as a Billing Specialist, gaining valuable insight into various accounting system software systems, billing processes, cash flow management, and other areas.

Agenda

- Scope
- Effective date
- Adoption
- Core principles
- Example
- Presentation and disclosures

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Scope and Background

Scope

- Excluded
  - Contributions
  - Leases
  - Investments
  - Equity method investments
  - Derivatives
  - Guarantees
  - Nonmonetary exchanges

Effective Date

- Effective for periods ending after December 15, 2018
  - For example: calendar year 2019
  - Years ending June 30, 2020
  - Years ending September 30, 2020

Adoption Method

- **Full retrospective approach.**
  - All prior reporting periods would be presented as though the new guidance had always been effective.
  - Certain practical expedients that the organization may choose to apply. The date of the cumulative effect adjustment would be the start of the earliest reporting period presented.
- **Modified retrospective approach.**
  - Cumulative effect of adopting the new guidance is recognized on the date of initial application.
  - Comparative periods prior to initial application are not restated.
  - Organizations using this approach would apply the guidance retrospectively either to all contracts as of the initial application date or only to those contracts that are not completed as of the initial application date.
  - When using this method, a practical expedient is available for certain contracts that were modified.

Core Principles

- Revenue should be recognized to depict the transfer of promised goods or services to customers at an amount representing the consideration to which the organization expects to be entitled in exchange for those goods or services.

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The 5 Steps

The 5 Steps

- Step 1: Identify customer contract
- Step 2: Identify performance obligations in the contract
- Step 3: Determine the price of the transaction
- Step 4: Allocate the transaction price to each performance obligation within the contract
- Step 5: Recognize revenue as performance obligations are satisfied

Step 1: Identify Customer Contract

- Contract: an agreement between two or more parties that creates enforceable rights and obligations. A contract may take many forms (that is, it may be written, verbal, or implied by ordinary business practices).

- Customer: party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Step 1: Identify Customer Contract

- Must meet all the following criteria:
  - It has commercial substance; that is, the amount, timing, or risk of future cash flows is expected to change as a result of the contract.
  - There is approval and commitment by each party to fulfill its obligations.
  - The payment terms and each party's rights to goods or services must be identifiable.
  - It is probable that the organization will collect substantially all the consideration for the exchange of the goods or services.

Example

- An NFP has a residential rehabilitation program where individuals learn to live independently. Services range from 24-hour onsite supervision to drop-in services. Those who are not eligible for public benefits are charged at flat subsidized rate of $150 per week. The client intends to pay the weekly rate when entering into the agreement but has no current income and is not eligible for benefits. Historically, the NFP has had trouble collecting fees from this class of customer.

Example

- An association provide members access to industry standards, advocacy, and discounts on conferences and trainings. Memberships are paid in advance and cover the twelve-month period ending December 31. There is no obligation to renew membership.

Step 1: Identify Customer Contract

- A contract does not exist if each party has the unilateral right to terminate an unperformed contract without compensating the other party.
- A contract is unperformed if :
  - no goods or services have been transferred to the customer, and
  - no consideration has been received or is entitled to be received in exchange for the goods or services.

Example

- An NFP enters into an agreement to provide consulting services to XYZ corp at a fixed price of $75,000. The services will be performed over a two-year period. The agreement specifies that XYZ corp can terminate the contract at any time and for any reason. There are no termination penalties.

Step 2: Identify Performance Obligations

- Performance obligation – a promise in a contract with a customer to transfer either:
  - A distinct good or service.
  - A series of distinct goods or services that are substantially the same and that transfer to the customer in the same pattern.

Step 2: Identify Performance Obligations

- A performance obligation is distinct if both of the following conditions exist:
  - The customer can benefit from the goods or service either on its own or with other resources that are readily available.
  - The promise to transfer the goods or services can be identified separately from other promises in the contract.

Step 2: Identify Performance Obligations

- Indicators that two or more promises to transfer goods or services are not separately identifiable include the following:
  - The good or service is an input used to create the end product (output) promised to the customer in the contract.
  - The good or service substantially changes or customizes another good or service promised in the contract.
  - The good or service is highly dependent on or highly interrelated with another good or service promised in the contract.

Example

- An NFP, enters into a contract with a customer to create a volunteer management system website, online database, and provide ongoing maintenance and technical support (online and telephone) for a two-year period. The entity sells the website/database, maintenance, and technical support separately. The website and database on not sold as separate services.

Step 3: Determine the Transaction Price

- Transaction price – amount of consideration to which an organization expects to be entitled for providing the promised goods or services to the customer, excluding sales taxes or similar amounts collected on behalf of third parties.

Step 3: Determine the Transaction Price

- Determine the effect of the following and assume the contract will not be renewed, cancelled, or modified:
  - Variable consideration
  - Constraints on estimates of variable consideration
  - Existence of significant financing components
  - Noncash consideration
  - Consideration payable to the customer

Step 3: Determine the Transaction Price

- Variable consideration is estimated using one of the following methods:
  - Expected value method – summing the probability-weighted amounts in a range of possible consideration amounts.
  - Most likely amount method – a single most likely amount within a range of amounts that are entitled to be received.

Example - Estimating Variable Consideration

- An NFP enters into a contract with a customer to build a levee in a flood prone area. This is an exchange transaction and the promise to transfer the levee is a performance obligation that is satisfied over time. The promised consideration is $2.5 million, but that amount will be reduced or increased depending on the timing of completion of the levee. Specifically, for each day after March 31, 2020 that the levee is incomplete, the promised consideration is reduced by $10,000. For each day before March 31, 2020 that the levee is complete, the promised consideration increases by $10,000.
- In addition, upon completion of the levee, a third party will inspect the levee and assign a rating based on metrics that are defined in the contract. If the levee receives a specified rating, the entity will be entitled to an incentive bonus of $150,000.

Example - Estimating Variable Consideration (continued)

- In determining the transaction price, the NFP prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods:
  - The NFP decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive(that is, $2.5 million, plus or minus $10,000 per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.
  - The NFP decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only 2 possible outcomes ($150,000 or $0) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

Step 4: Allocate the Transaction Price

- Allocate to each performance obligation
- Allocate to each performance obligations based on the relative standalone price at contract inception

Step 4: Allocate the Transaction Price

- Estimation methods for standalone selling price:
  - Adjusted market assessment approach
  - Expected costs plus a margin approach
  - Residual approach

Example - Allocation Methodology

- An NFP enters into a contract with a customer to sell (1) an ebook, (2) a live webinar course and (3) an in-person training course in exchange for $750. The entity will satisfy the performance obligations for each of these products at different points in time. The entity regularly sells the e-book and the in-person training course separately, and, therefore the standalone selling prices are directly observable. The standalone selling price of the live webinar (historically bundled services only) is not directly observable.

Example - Allocation Methodology (continued)

- Because the standalone selling prices for webinar is not directly observable, the NFP must estimate it. To estimate the stand-alone selling prices, the NFP uses the adjusted market assessment approach. In making the estimate, the NFP maximizes the use of observable inputs. The NFP estimates the standalone selling prices as follows:

Product/Service	Price	Estimation method
E-book	250	Directly observable
Webinar	200	Adjusted market approach
In-person	400	Directly observable
Total	850	

Example - Allocation Methodology (continued)

- The customer receives a discount for purchasing the bundle of goods because the sum of the standalone selling prices ($850) exceeds the promised consideration ($750). The NFP considers whether it has observable evidence about the performance obligation to which the entire discount belongs and concludes that it does not. Consequently, the discount is allocated proportionately across all three products/services. The discount, and therefore the transaction price, is allocated as follows:

Product/Service	Price	% of total price	Allocated price
E-book	250	29%	221
Webinar	200	24%	176
In-person	400	47%	353
Total	850		750

Step 4: Allocate the Transaction Price

- Subsequent transaction price changes:
  - Allocate the change on the same basis at contract inception
  - Recognized as increases or decreases in revenue in the period the change occurs

Step 5: Recognize revenue

- Over a period of time, or
- At a point in time

- When the customer takes control of the good or service

Step 5: Recognize revenue

- Performance obligation is satisfied over time when at least one of the following criteria is met:
  - As the organization performs the obligation, the customer simultaneously receives and consumes the benefits.
  - The customer controls the asset as the organization creates or enhances it.
  - The performing organization has no alternative use for the asset being created (for example, it is not salable to another customer), and it has an enforceable right to receive payment for its performance completed to date.

Step 5: Recognize revenue

- Recognizing revenue over time
  - Output method
  - Input method
- Method should be applied consistently

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Example – Membership Dues

Example - Membership Dues

- The Accounting Peoples Association (APA) requires members to pay annual dues of $1,000
- Dues cover a calendar year (same as fiscal year)
- Invoiced in October for the following calendar year
- Members receive:
  - Access to industry information/standards ($500)
  - Advocacy ($500)
  - The quarterly periodical, *Accounting Peoples Today ($100)*
  - Right to be identify themselves as official members ($???)
- No obligation to renew membership

Example - Membership Dues

- Step 1: Identify the contract
  - It has commercial substance
  - There is approval and commitment by each party to fulfill its obligations.
  - The payment terms are be identifiable.
  - It is probable that the organization will collect substantially all the consideration for the exchange of the goods or services.

Example - Membership Dues

- Step 2: Identify the performance obligations
  - Good or service (or a bundle of goods or services) that is distinct; or a series of distinct good or services that are substantially the same and that have the same pattern of transfer to the customer.
  - Capable of being distinct. Can the customer benefit from the promised good or service, either on its own or together with other resources that are readily available to the customer?
  - Distinct within the context of the contract. Is the promise to transfer the good or service separately identifiable from other promises in the contract?

Example - Membership Dues

- Step 3: Determine the transaction price
  - Variable consideration
  - Constraining estimates of variable consideration
  - Noncash consideration
  - Consideration payable to the customer

Example - Membership Dues

- Step 4: Allocate the transaction price to the performance obligations
  - Standalone selling price
    - If not observable, estimate it
  - Discounts relate to only one or some performance obligations?
  - Material rights

Example - Membership Dues

Performance obligation	Selling price	Percentage of selling price	Allocated to transaction price
Membership benefits	$ 1,000	91%	$ 909
Quarterly journal	$ 25	2%	$ 23
Quarterly journal	$ 25	2%	$ 23
Quarterly journal	$ 25	2%	$ 23
Quarterly journal	$ 25	2%	$ 23
	$ 1,100	100%	$ 1,000

Example - Membership Dues

- Step 5: Recognize revenue
  - At a point in time or over time
    - A good or service is transferred when (or as) the customer obtains control of that good or service.
    - Criteria for over time:
      - The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
      - The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
      - The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

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Presentation and Disclosures

Disclosure requirements

- Help readers understand the following aspects of revenue and cash flows:
  1. Nature
  2. Amount
  3. Timing
  4. Uncertainty

Customer contracts

- Present revenue and contract assets with customers separately from other sources.
- Either (1) breakout of revenue into one or more categories or (2) breakout of revenue between how control is transferred to customers (over time vs. point in time), and
- Qualitative information about how economic factors (such as type of customer, geographic allocation of customers, and type of contract) affect the nature, amount, timing, and uncertainty of revenue and cash flows.

Contract balances

- Must disclose each of the following as of the beginning and end of the reporting period:
  - Receivables from customer contracts
  - Contract assets
  - Contract liabilities

- **Note**: This is only if the amounts are not presented separately on the statement.

Performance obligations

- Nature of goods and services promised.
  - Significant payment term, including the following:
    - When payment typically is due;
    - Whether a contract includes a significant financing component;
    - Whether any consideration is variable; and
    - If any consideration is variable, whether the entity's estimate of variable consideration is typically constrained.
  - When performance obligations are typically satisfied.
  - Obligations for:
    - Returns;
    - Refunds; and
    - Similar obligations.

Significant judgements made

- Judgements and changes in judgements used to determine:
  - The timing of the satisfaction of performance obligations; and
  - The transaction price and amounts allocated to performance obligations.
- For performance obligations satisfied over time:
  - Description of the input method (or output method) used to measure progress; and
  - Explanation of how the entity applies the input method (or output method).
- Methods, inputs, and assumptions the entity uses to assess whether variable consideration is constrained.

Adoption – modified retrospective

- Applied to all contracts or only those that were not completed.
- If the partial expedient was used.
- Current period balances under current and previous GAAP. Must disclosure changes from previous GAAP in revenue, contract assets and liabilities.

Costs to get a contract

- Are the costs incremental?
- Are the costs recoverable?

Contract modifications

- Questions to consider
  - Are there changes in scope **or** price.
  - Are there changes in scope **and** price.
  - Do changes add distinct goods or services?
  - Are changes at standalone selling prices?

- Possible outcomes
  - New contract that replaces the original
  - New contract separate form the original
  - Modified contract
  - Mix of both

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Questions?

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