Revenue Recognition for NFPs

Session 6D

May 17, 2023

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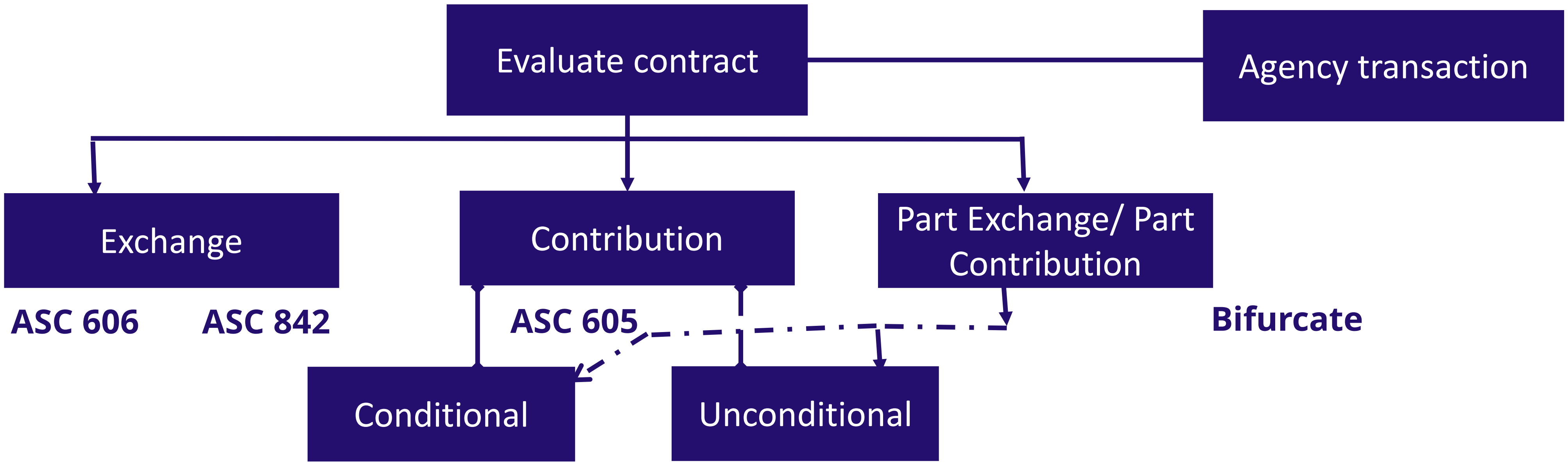
KAPLAN

Relevant Literature

- ASC 606, Revenue recognition for exchange transactions
- ASC 605
  - Grants (conditional vs unconditional contributions)
  - Contributions of nonfinancial assets
  - Long term contributions (promises to give)
  - Agency transactions
  - Split interest agreements
  - Donations of Collection Items
  - Below market leases or loans
- Sometimes it's not so straight-forward.
- Importance of evaluating the document- generally not as easy as the examples in the literature

Revenue Recognition- Flowchart



NFPs participate in exchange transactions and are the beneficiaries of financial and nonfinancial contributions. Some transactions should be bifurcated. Even contributions have a decision tree- conditional vs unconditional.

Case Study 1- Exchange vs. Contribution, Bifurcation

A Foundation received a contribution from pharmaceutical company each year to help fund a magazine that was distributed free to physician's offices and clinics. The advancement department wanted to double the contributions from its recurring donors, so they asked the Company for $200,000. The advancement personnel relayed the information to the accounting department, that the donation was larger in the current year. It was recorded as a contribution with donor restrictions on the date that the agreement was signed by the recurring gifts manager. During the financial statement audit, an auditor selected that transaction for testing revenue recognition. After reading the agreement she asked the accounting manager why the $200,000 was recorded in its entirety as a contribution with donor restrictions when the contract stated that the Foundation was to provide 1 page for the Company to use in each issue of the magazine issue printed that year. The auditor showed the accounting manager a copy of the magazine that contained a one-page pharmaceutical ad. The accounting manager found that the accounting staff recorded the transaction without thoroughly understanding the contract. A journal entry was required to correct the error. The audit reported this issue as a material weakness in internal control.

Revenue Recognition- Exchange Transactions

Relevant Literature:

- ASC 958-606, *Revenue Recognition*
- Principles-based approach

Step 1: Identify the contract with the customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

Revenue Recognition- Exchange Transactions

Examples

- Higher education- tuition and housing-
  - Generally accounted for over time. Evaluate for revenue constraints such as discounts or policies that provide reductions in tuition or housing
  - Deposits cannot be taken into revenue until services begin and only to the extent services are performed.
- Social service and healthcare organizations- patient care/ client fees
  - Collectability may be an issue and revenue cannot be recognized unless collectability is **probable.**
  - Estimates can be made for constrained revenue to meet recognition criteria (Medicaid pending or charity discounts)

Revenue Recognition- Exchange Transactions

Examples

- Membership organizations- typically collectability is not an issue
- Determination of whether the membership represents an exchange (trade group) or a contribution, or both
- Material right

Membership - Example

Step 1: Identify the Contract with the Customer

- In order for the exchange portion of membership dues or subscriptions or a life-time membership or subscription to be a contract with a customer:
    - The contract is approved, and the parties are committed to their obligations.
    - The NFP can identify each party's rights to the goods or services being provided.
    - The NFP can identify the payment terms for the goods or services to be transferred.
    - The contract has commercial substance.
    - Probable that the not-for-profit will collect substantially all of the consideration to which it will be entitled

Membership - Example

- Membership organizations usually require payment in advance for memberships including life-time memberships, and life-time subscriptions
- FinREC believes that the criteria of a contract are generally met when the order is placed.
- When a membership organization bills for a renewal in advance, before the beginning of the service period even if the criteria were met, the organization still needs to consider whether either party to the contract has performed.
- If cash has changed hands but performance has not occurred, then there is a contract liability.
- Receivable would not be recorded until the earliest of meeting the performance obligation or, under a noncancellable contract, when the entity has an unconditional right to consideration.

Membership - Example

A firm has several clients that are membership organizations.

A. **Membership to Social Service Organization:** Social service organization that provides job counseling to clients and helps them to find low- income housing. Memberships are like sponsorships. There is no reciprocal transaction. Memberships are tiered (Sustainer, Silver, Gold, Platinum) No member has more benefits than another except their name listed in a different category on publications and on the website.

Analysis: There are no reciprocal benefits, therefore this is a contribution. The membership organization records the amount of the donation at the time of the cash receipt or the pledge if there is sufficient documentation and it is unconditional.

Membership - Example

A firm has several clients that are membership organizations.

B. **Zoo Membership:** A zoo that provides a member with a family pass with unlimited use. The member also gets a 20% discount on refreshments and merchandise. The member also gets an invitation to Fright Night at the Zoo. This is a family night at the zoo with special guided tours and activities for children. A family pass costs **$75 for a day**. Zoo stats show that people use the pass an average of **2.25 times.** Only members can attend Fright Night. The Zoo values this benefit at **$40**. The membership is **$150**.

Step 1 Analysis: The arrangement is a contract. There is reciprocal benefit. Cash is paid at the time of the transaction so there is no issue with collectability.

Membership - Example

Step 2: Identify the Performance Obligations

- A performance obligation is defined in ASC 606 as a promise in a contract with a customer to transfer to the customer either:
  - A good or service (or a bundle of goods or services) that is distinct.
  - A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Membership - Example

Step 2: Identify the Performance Obligations

- Membership dues entitle the member to multiple benefits the entity would ask:
  - 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, **and**
  - is the promise to transfer the good or service separately identifiable from other promises in the contract?
- If the membership organization sells the benefit on a standalone basis, this is a good indicator that the customer can benefit from the good or service on its own or together with other resources that are readily available.

Membership - Example

Step 2: Identify the Performance Obligations

- **Material right** to the customer – a CPA association often provides discounts on CPE only to its members.
  - ASC 606 states that an entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer but discounts that provide material rights cannot be deemed immaterial.
  - Option to purchase a discounted product or service provides a material right to the customer – the customer is paying the entity in advance for future goods or services.
  - The entity recognizes revenue when those future goods or services are transferred or when the option expires.

Membership - Example

Step 2 Analysis:

The organization identifies the performance obligations.

- Zoo tickets for a family – fair value $75 each visit
- Fright Night at the Zoo ticket- $40 for the event
- Material right to buy merchandise and refreshments at a discount

Membership - Example

Step 3: Determine the Transaction Price

- Amount of consideration that the organization expects to be entitled to in exchange for transferring promised goods or services to a member (customer).
- To determine the transaction price, an entity should consider the effects of:
    - Variable consideration
    - Constraining estimates of variable consideration
    - The existence of a significant financing component
    - Noncash consideration
    - Consideration payable to the customer
- **Step 3 Analysis: The transaction price is $150**. In this case study, there is no variable consideration. Any purchases are outside the transaction. There is no noncash consideration, no refunds and cash is paid at the time of the transaction.

Membership - Example

Step 4: Allocate the Transaction Price when There Is More than One Performance Obligation

- Look for a standalone selling price. If it is not observable, it should be estimated.
- If a discount applies to one of the performance obligations, then it would be allocated there.

Step 4 Analysis: The transaction has 3 performance obligations.

- Family ticket (unlimited use) $110. Based on research the zoo believes that this benefit has a fair value of $110 based on estimated usage.
- FrightNight at the Zoo- Event (stand alone price $40 based on other events held by the zoo not included in the membership)
- Material Right- to buy merchandise at a discount.

Membership - Example

Material Right Calculation			
Value of incremental purchase		$ 80	
Likelihood of purchase		0.85	
Discount		0.2	
Value of discount		$ 13.60	
Contract Price		$ 150.00	91.69%
Value of discount		$ 13.60	8.31%
		$ 163.60	100.00%
Proportion of discount		8.31%	
Contract Price		$ 150.00	
Value of discount		$ 12.47	
Value of other benefits		$ 137.53	

Purchase price attributable to other benefits

Fright night at the zoo	$ 40	27%	$ 36.67
Family membership	$ 110	73%	$ 100.86
	$ 150	100%	$ 137.53

- Fright night at the zoo (point in time)
- Family membership (over time)

Membership - Example

Step 5: Recognize Revenue when or as Performance Obligations Are Satisfied over Time when:

- Customer simultaneously receives and consumes the benefits provided as the entity performs.

- **Performance Obligations Are Satisfied over Time**
  - When the transfer occurs
- **Step 5 Analysis:** The original visit has a fair value of $75. The Fright Night benefit has a fair value of $40. The entity recognizes revenue at a point in time for these benefits. The member may or may not take advantage of future benefits so they would be recognized over time including the value of the material right.

	Performance Obligation	Allocated			
Fright night at the zoo	40.00	36.00		Point in time	
Family membership- 1st visit	75.00	68.00		Point in time	
Family membership (remainder)	35.00	32.00		Over time	
Material right	13.60	14.00		Over time	
	$ 163.60	$ 150.00			

The price is only $150 so each obligation has to be reduced proportionately!

Disclosure Required for Private Companies

Disaggregated Revenue

- Quantitative revenue information disaggregated based on whether performance obligations are satisfied over time or at a point in time
- Qualitative information about how economic factors affect the nature, timing and uncertainty of revenue and cash flows.

Performance Obligations

- When performance obligations are typically satisfied
- Significant payment terms including variable consideration and significant financial components
- Nature of goods or services the company has promised to transfer
- Obligations for refunds, refunds and other similar obligations
- Types of warranties and related obligations

Disclosure Required for Private Companies

Contract Balances

- Opening and closing balance of receivables, contact assets and contract liabilities

Significant Judgments

- Method used to recognize revenue for performance obligations satisfied over time (input or output method) and how the method was applied
- Methods, inputs and assumptions used to evaluate whether an estimate of variable consideration is constrained.

Grants and Contributions- Step by Step Process

Step 1: Determine if the Transaction is an Exchange or Contribution

- The concepts used for classifying government grants as exchange or contribution are similar to the criteria the federal government uses when categorizing federal awards.
  - In a procurement arrangement, the funding provides for goods or services for the government's direct benefit or use.
  - But if the principal benefit is to support activity that is not for the government's direct benefit, then the award is either a grant or cooperative agreement.
  - These would be considered nonreciprocal for purposes of accounting literature.
  - The terminology used as a financial statement caption can continue to be grant support or whatever the entity currently uses.
- Government as a third-party payor

Grants and Contributions

Step 2: If deemed a contribution, determine if it is conditional or unconditional

- The recipient must meet the conditions set forth by the resource provider to receive the funding. Until that happens, the funding entity defers recognition of an expense and the recipient defers recognition of revenue.
- Donor-imposed condition is one where:
  - The recipient has to overcome a barrier or hurdle to be entitled to the resources.
  - The grantor is released from the obligation to fund or has the right to return advanced funding if the recipient fails to overcome the barrier.
  - **Both requirements must be present** for an agreement to be conditional. If the terms of a grant are not clear, then the grant is presumed to be conditional.

Grants and Contributions

- **Unconditional contributions** are **recognized immediately** and classified as either net assets with donor restrictions or net assets without donor restrictions.
- **Conditional contributions** are **accounted for as a liability or not recognized** until the barriers to entitlement are overcome.
- Then the transaction is recognized as unconditional and classified as either net assets with donor restrictions or net assets without donor restrictions.
- The key to the evaluation lies in the word **entitlement**. With unconditional contributions the entitlement is there. The resource use is specified. (IF vs. WHEN)

Grants and Contributions

- Conditional contribution, the entity is not entitled to the resources until barriers are overcome.
- Neither the likelihood that a barrier will be met nor the resources provider's intent to enforce the right of return is to be considered when determining whether funding is conditional.
- Term "probability is remote" has no bearing on these decisions.
- Conditional contribution can only become unconditional when the condition is substantially met.
- Agreement does not need to include the specific phrase **right of return** or **release from obligation.**
- Agreement should be able to support a reasonable conclusion about when an NFP would be entitled to the transfer of assets.

Grants and Contributions

- Inclusion of a **measurable performance-related barrier** indicating that the entitlement is contingent on achievement of an outcome, level of service, or other measurable barrier such as cost sharing/matching.
- NFP's discretion is limited on the way they can conduct an activity such as allowable costs, hiring specific people for the project, a protocol that must be followed, etc.
- Administrative requirements such as providing a report or obtaining an audit are not enough to be considered a barrier.

Grants and Contributions- What would you do?

- A NFP wants to take advantage of the Employee Retention Credit
- Not like PPP in that it is a credit not a loan
- It is government funding and there is a barrier and right of return/release.
- The year end is December 31, 2022. The entity still has time to file for the credit and has been saying they are going to file since January 2022. The controller has not produced a calculation or any support for the auditor.
- Does the organization have revenue at December 31, 2022?
- Would the filing of the application for the credit be considered an administrative requirement?

Grants and Contributions- Example 1

A NFP is awarded a grant which spans 5 years. The grant agreement stipulates that the NFP is required to provide a cost sharing amount in each of the 5 years equal to 10 percent of the year's funding in order to be entitled to the funding. If the cost share is not met in a **particular year** the grantor is not obligated to fund that year's amount according to the agreement. If payment is made by the grantor in advance the NFP is required to return the funding if requested. Is the cost share a barrier?

Analysis: The NFP has a condition. If funding is received in advance the cash would be recorded along with a refundable advance. If not, nothing would be recorded. **(FASB Staff Q&A)**

- The NFP recognizes revenue each year. The fact that the grantor has never asked for repayment because the match was not complete does not enter into the accounting.
- The auditor should read the grant very carefully to determine how much of the funding is considered to be at risk. Generally, when a grant is worded this way, it will be the amount of the yearly cost share. There are cases where it is an all or nothing scenario.

Grants and Contributions- Example 2

A NFP receives a $500,000 grant. The funding is provided in equal installments. The NFP must provide, from its own resources, an amount equal to 10 percent of the total grant award by the end of the last year of a 5-year grant in order to be entitled to the grant funds. There is no specific requirement that must be met each year to be entitled to funds for that year. The agreement indicates that failure to meet the cost-sharing requirement may result in grant funds being returned to the funder in an amount equal to that by which the actual cost share is less than the required cost share. Is the cost share a barrier?

Analysis: The NFP considers the amount that is at risk ($50,000). In years 1-4 the total amount of the funding can be considered unconditional (unless there are other conditions). **(FASB Staff Q&A)**

Grants and Contributions- Example 3

A NFP received a grant from a Foundation. The grant had no specific performance barriers in it. However, the grant stated that the NFP had to submit a budget and then report each quarter. Deviations of 20% for a line item had to be approved. Is this grant a conditional or unconditional contribution?

Analysis: The FASB Staff Q&A states that budgets are typically guidelines. The auditor should ask questions to ensure there are no other documents or addenda. In this case the auditor concluded there was no barrier, so the grant was an unconditional contribution only to learn later that the NFP failed to provide them with an appendix to the grant that appeared to be a list of allowable and unallowable costs taken from the Uniform Guidance.

Grants and Contributions- Example 4

A Community Foundation provided funding to a YMCA in the amount of $1 million. The period of performance was 1 year. The funding was to be spent for meal distribution and similar activities wither in a new program created by the recipient or an existing program related to COVID-19 issues. Grant funds cannot be used to supplant state and federal funding. Funds cannot be used to cover costs that are eligible for reimbursement, or which have been reimbursed through federal or state recovery dollars.

The grant document contained a budget. Violations of the grant called for return of funding. The grant contained an appendix with a link to the Treasury's CRF program.

Analysis: Client did not identify this as a federal award. The auditor did not choose the grant as a revenue test selection.   Shortly after year end the client called the auditor and told them about another document that the YMCA sent them. It referred to the grant as a subaward.

Grants and Contributions- Simultaneous Release Option

- NFPs can make an election to report donor restricted revenue as without donor restricted revenue if the release occurs in the same period. (simultaneous release)
- This is a policy election that can be made as long as the same policy election is elected for donor-restricted investment return.
- 2018-08 allows a simultaneous release which is not dependent on the election above.
- This must be disclosed in the accounting policies.

	No accounting policy election Net Assets		With accounting policy election Net Assets	
	Without Donor restrictions	**With Donor restrictions**	**Without Donor restrictions**	**With Donor restrictions**
Grants and Contracts		$ 1,000,000	$ 1,000,000	
Contributions		500,000		500,000
Net assets released from restrictions	1,300,000	(1,300,000)	300,000	(300,000)
	$ 1,300,000	$ 200,000	$ 1,300,000	$ 200,000

Grants and Contributions

Disclosure Requirements

Recipients

- Unconditional contributions – amount of promises receivable in less than one year, in one to five years and in more than five years
- Allowance for uncollectible promises receivable
- Conditional contributions – amount promised and a description and amount for each group of promises with similar characteristics

Resource Providers

- Schedule of unconditional promises to give showing the amounts payable in each of the next five years and the aggregate after that
- Unconditional promises to give reported using present value techniques - unamortized discount
- Conditional promises – consider the requirements of ASC 450

Contributed Nonfinancial Assets

- Contributions assets are recorded at fair value at the date of donation.
- Contributed services are too but there are different rules for recognition.
- The services must either create or enhance a nonfinancial asset
- Require **specialized skills** provided by entities or persons possessing those skills, **and the organization would need otherwise to purchase those services if not donated**.

Contributed Nonfinancial Assets- Example

A large not-for-profit foundation had several regional affiliates around the country that bore the name of the parent. Executive management decided to acquire the affiliates that were not performing well, streamline operations, including eliminating most of the regional executives, and service the region's administrative needs through the parent's shared service department. This plan required a significant amount of legal work which was performed by a board member.

In 20X1 the entity changed audit firms and during the client acceptance procedures the successor auditor reviewed the financial statements. The auditor noted that there was very little legal expense and inquired about it. She learned about the board member's role in executing the acquisitions which was above and beyond the responsibilities of a board member. She informed management and the board that if the firm accepted the entity as a client there would be a restatement required since the amount was material. This would need to be discussed with the predecessor auditor. Management acknowledged that they had never known that the services should be recorded as nonfinancial contributions.

Contributed Nonfinancial Assets- Valuation

- Fair value is the estimated price at which an asset can be sold, or a liability settled in an orderly transaction to a third party under current market conditions.
- 958-605 - tailored guidance for donated nonfinancial assets either to be used in the provision of the services, sold, or used in fundraising.
- Measuring the fair value is challenging because:
  - Gifts do not generally have an active market
  - Some gifts, (preservation easements) are not generally bought or sold
  - Some gifts are items a not-for-profit would not otherwise purchase
  - Many gifts are not used at their highest and best use by not-for-profits.
- Consider Levels 1, 2 and 3
  - Level 1- information can be found on Amazon or another source for identical asset
  - Level 2- wholesale price index for certain goods
  - Level 3- appraisal

Contributed Nonfinancial Assets- Valuation

- The FinREC believes that the market in which an NFP would normally sell or distribute the asset may not be the principal market
- A not-for-profit may be more interested fulfilling mission than maximizing the amount they would get from selling the assets.
- Therefore, the entity would **not** look to the amount the beneficiaries receiving gifts in kind from not-for-profits would pay since those amounts are not a good indicator of a principal market.
- The market in which the goods would normally be sold is the market that should be considered.

Contributed Nonfinancial Assets- Valuation

- Donor-imposed restrictions limit the use of the nonfinancial asset to a use other than its highest and best use.
- For example, a donor may provide gifts in kind to a not-for-profit and require that they be restricted to specific geographic locations or sold at auction immediately with the proceeds restricted to a particular program. **This would not alter the fair value but alters the net asset classification.**
- If the **limitation was on the asset itself** such as a land easement on land then the fair value would be altered because it would alter the perception of the market participant

Contributed Nonfinancial Assets- Example

A NFP International Health Organization receives donations of drugs and supplies from pharmaceutical companies and USAID and sends them overseas. The donations provided by USAID are valued by the federal agency. Those coming from the pharmaceutical companies are valued by the NFP. Many of the products are close to their expiration date which does not diminish their service value but would diminish their financial value.

Although some of the overseas clinics pay something for the products, this is also not a good indicator or fair value. The NFP has a mission motive so this value would be too low.

Contributed Nonfinancial Assets

- NFPs receive items, that are to be used for fundraising purposes
- When the eventual sale happens those gifts in kind can be directly attributed to the original gift from the donor.
- The not-for-profit will report the original contribution as revenue measured at fair value at the date of donation.
- The difference between the amount received for those items from participants at fundraisers and the fair value when originally contributed to is an adjustments to the original contributions.

ASU 2020-07, Contributed Nonfinancial Assets

- The not-for-profit will present contributed nonfinancial assets in a separate line item from contributions of cash or other financial assets.

Not-for-Profit Social Service Agency	
Statement of Activities	
Year Ended June 30, 20X1	
Changes in net assets without donor restrictions	
Revenues and gains:	
Contributions of cash and other financial assets	$ 6,790
Contributions of nonfinancial assets	**1,850**
Fees	5,200
Investment return (net)	6,650
Gain on sale of equipment	200
Other	150
Total revenues and gains without donor restrictions	$ 20,840

ASU 2020-07, Contributed Nonfinancial Assets

Disclosure Requirement	Implementation Tip
Qualitative information about whether the contributed nonfinancial assets were either monetized or utilized during the reporting period The entity's **policy** for monetizing rather than utilizing contributed nonfinancial assets	Management should ensure that they have a **process in place** for determining whether contributed nonfinancial assets were either monetized or used during the reporting period. Management should also consider how this disclosure requirement aligns with their requirement to disclose their policy (if any) about monetizing rather than using contributed nonfinancial assets. Management should determine whether they **have this policy** and, if so, how it aligns with their policy for categories designated for disaggregation of the contributed nonfinancial assets.

ASU 2020-07, Contributed Nonfinancial Assets

Disclosure requirement	Implementation Tip
If assets were utilized, a **description of the programs** or other **activities** in which those assets were used.	Management must consider how this disclosure requirement aligns with the requirement to describe programs or activities elsewhere in the financial statements.
Description of any related donor restrictions	Not-for-profits should ensure that they have a process in place for determining which contributed nonfinancial assets are subject to donor-imposed restrictions.

ASU 2020-07, Contributed Nonfinancial Assets

Disclosure requirement	Implementation Tip
Description of the **valuation techniques and inputs** used to arrive at a fair value measure at initial recognition.	ASC 820 requires all entities to disclose the valuation techniques and inputs used for assets and liabilities that are measured at fair value on a recurring or nonrecurring basis after initial recognition. This does not generally include contributed nonfinancial assets unless they are subsequently remeasured, for example when impaired. **Under the ASU, not-for-profits must now disclose a description of the valuation techniques and inputs used in the fair value measurement of contributed nonfinancial assets at initial recognition.**

ASU 2020-07, Contributed Nonfinancial Assets

Disclosure Requirement	Implementation Tip
The **principal market** (or most advantageous market) used to arrive at a fair value measurement **<u>if it is a market in which the entity is prohibited by donor restrictions from selling</u>** <u>or using the contributed nonfinancial asset.</u>	This disclosure allows not-for-profits to demonstrate that **donor-imposed restrictions** do not affect the measurement of contributed nonfinancial assets given that fair value is a **market-based** rather than entity-specific measurement.

Contributed Nonfinancial Assets- Example Policy Note

The Organization receives gifts in kind, such as medical equipment, prescription drugs and other medical supplies for use in treating low-income individuals. Revenue from the receipt of nonfinancial assets is recognized in circumstances in which the organization has sufficient discretion over the use and disposition of the items to recognize contributions. Contributions are valued and recorded as revenue at their fair value at the date of donation.

When the Organization distributes gifts in-kind as part of its own programs it reports an expense which is reported in the functional classification in which the gifts in kind were used. Undistributed gifts in kind are reported as inventory at year end. It is valued at the lower of cost or net realizable value.

Contributed Nonfinancial Assets- Example Footnote

Contributed Nonfinancial Assets (one year presentation)

For the year ended June 30, 20X1 contributed nonfinancial assets recognized within the statement of activities (in thousands) included:

	20X1
Building	$ 1,155
Food	45
Medical supplies	172
Pharmacuticals	213
Clothing	25
Vehicles	73
Services	167
	$ 1,850

Contributed Nonfinancial Assets- Example Footnote (con't)

The Agency recognized contributed nonfinancial assets within revenue, including a contributed building, vehicles, food, medical supplies, pharmaceuticals, clothing, and services. Unless otherwise noted, contributed nonfinancial assets did not have donor-imposed restrictions.

It is the Agency's policy to sell all contributed vehicles immediately upon receipt at auction or for salvage unless the vehicle is restricted for use in a specific program by the donor. No vehicles received during the period were restricted for use. All vehicles were sold and valued according to the actual cash proceeds on their disposition.

The contributed building will be used for general and administrative activities. In valuing the contributed building, the Agency estimated the fair value on the basis of recent comparable sales prices in the Baltimore real estate market.

Contributed Nonfinancial Assets- Example Footnote (con't)

Contributed food was utilized in the following programs: domestic community development, and services to community shelters. Contributed clothing was used in the Agency's homeless shelter. Contributed medical supplies were utilized in the Agency's medical clinics. In food, clothing, and medical supplies, the Agency estimated the fair value on the basis of estimates of wholesale values that would be received for selling similar products in the United States.

Contributed pharmaceuticals were restricted by donors to use outside in the metropolitan Baltimore area and were utilized in programs for underserved adults and children. In valuing contributed pharmaceuticals the Agency used the Federal Upper Limit based on the weighted average of the most recently reported monthly Average Manufacturer Prices (AMP) that approximate wholesale prices in the United States (that is, the principal market).

Contributed services recognized comprise professional services from attorneys advising the Agency on various administrative legal matters. Contributed services are valued and are reported at the estimated fair value in the financial statements based on current rates for similar legal services.

Contributions and Contributions Receivable

- Contributions represent unconditional, nonreciprocal gifts of assets (or settlement of its liabilities) from one entity to another
- Financial (securities or cash) or nonfinancial assets
- Contributions may have donor-imposed restrictions
- Contributions may be promises to give- long term or short term.
- Measurement- fair value date of donation

Contributions and Contributions Receivable

- Promises to give within the next year are deemed to be at fair value
- Promises to give greater than a year must be recorded at fair value (ASC 820)
- Fair value of a long-term contribution -based on the present value of expected future cash flows
- NFP considers the creditworthiness of the parties, its past collection experience and policies about enforcing promises to give
- NFP also considers the economic climate that may affect future cash flows

Contributions and Contributions Receivable

- ASC 820-10-55 discusses two types of present value techniques:

1. **DRA – Discount Rate Adjustment-** most likely or projected cash flows derived from observed rates of return for comparable assets or liabilities that are traded in the market, the amount that market participants would demand for bearing the uncertainty inherent in the cash flows.

2. **EPV – Expected Present Value- 2 methods**

   - **EPV 1 - risk-free** rate of return is appropriate. The expected (probability weighted) cash flows (or expected value) are adjusted for general market risk by subtracting the cash risk premium.

   - **EPV 2**- a probability weighted cash flow or expected value. An **adjusted risk-free rate** is used. The risk-free rate is adjusted for general market risk by adding a risk premium. This adjusted rate is the expected rate of return

Example- Fair Value of Contributions Receivable

In 20X5 an independent school held a capital campaign and raised $3,000,000. The amounts were to be paid by the donors ratably over five years. The controller realized that she had to be realistic in her expectations. She was aware that recessions happened every 8-10 years and this could impact the collectability of the receivables, maybe not this year but in the coming years. She also evaluated the results of the previous capital campaign which was held five years ago in 20X0 to determine the most likely amount that would be collected.

Previous campaign results- 20X0

Type of Donor	Average Donation	Amount Pledged Total for Campaign	Percentage of Total Pledged	Amount Collected	Percentage Collected
Individual (parents - high net worth, large givers)	130,781	2,615,620	78.50%	2,432,527	93%
Individual (parents - smaller givers)	511	583,100	17.50%	524,790	90%
Teachers and employees of the school	1,111	83,300	2.50%	73,304	88%
Corporations	12,495	49,980	1.50%	50,000	100%
	144,897	3,332,000	100%	3,080,621	92%

Example- Fair Value of Contributions Receivable (con't)

The controller sought information from three similar schools that had capital campaigns. She did this because she wanted to first use probability weighted-cash flows. The information provided by the other schools was derived from periods when a recession was present and she used this to forecast the **most likely cash flow**. Because donors default at different percentages, she considered the most likely cash flow to be derived from the campaign by donor type

Information obtained from other schools reflecting percentage collected in less favorable times.

Type of Donor	% Collected of Amounts Promised To Date School 1	% Collected of Amounts Promised To Date School 2	% Collected of Amounts Promised To Date School 3
Individual (parents - high net worth, large givers)	90%	95%	94%
Individual (parents - smaller givers)	85%	87%	91%
Teachers and employees of the school	82%	89%	92%
Corporations	100%	100%	100%

Example- Fair Value of Contributions Receivable (con't)

The controller developed the most likely amount to be received from each group of donors using a probability weighted approach.

(Expected pledges of $3,000,000 - rounded)	
Probability weighted cash flows	**Individual High Net Worth**
Seventy-five percent chance of getting 92%	1,624,950
Ten percent chance of getting 95%	223,725
Fifteen percent chance of getting 90%	317,925
Projected collections	2,166,600
Percentage Collectible (weighted average)	92%
Probability weighted cash flows	**Individual - Smaller**
Fifty percent chance of getting 90%	236,250
Twenty percent chance of getting 87%	91,350
Twenty percent chance of getting 91%	95,550
Ten percent chance of getting 85%	44,625
	467,775
	89%

Probability weighted cash flows	**Teachers & Employees**
Fifty percent chance of getting 93%	34,875
Twenty percent chance of getting 92%	13,800
Fifteen percent chance of getting 89%	10,013
Fifteen percent chance of getting 82%	9,225
	67,913
	91%
Probability weighted cash flows	**Corporations**
Ninety percent chance of getting 100%	40,500
Ten percent chance of getting 95%	4,275
	44,775
	100%
Total expected pledges to be collected	2,747,063
Percentage of total pledges dollars	92%

Example- Fair Value of Contributions Receivable (con't)

Discount rate: Since the DRA method was ultimately used controller identified an unsecured borrowing rate for an individual of 5.5%. This was used for the most credit-worthy of the donors. Two percent was added to the unsecured rate for the credit-worthy for a resulting rate of 7.5%, reflecting the risk in the teacher/employee category and the smaller donor category. A corporate rate of 3.5% was used. The controller wanted to be conservative in the amount she recorded to limit adjustments later on.

Actual 20X5 campaign results

	Pledged	Amount per year	Estimated % Collectible	Estimated $ Collectible	Discount Rate	Discounted Cash Flow
Individual (parents - high net worth, large givers)	2,196,000	439,200	93%	408,456	5.50%	1,744,223
Individual (parents - smaller givers)	610,000	122,000	90%	109,800	7.50%	444,238
Teachers and employees of the school	457,500	91,500	88%	80,520	7.50%	325,775
Corporations	250,000	50,000	100%	50,020	3.50%	225,843
	3,513,500	702,700	93%	648,796		2,740,079
Amount of the discount on pledges receivable	503,901					
[(648,796 X 5) - 2,470,079]						

Example- Fair Value of Contributions Receivable (con't)

Journal Entry

Pledges receivable	3,243,890	
Discount on pledges receivable		503,901
Contribution revenue with donor restriction		2,740,079

To record pledges receivable and contribution revenue restricted for purpose and timing.

Each year as the cash is due the release from restriction occurs provided the purpose restriction is met. The discount is amortized into contribution revenue – without donor restriction.

When cash is received the receivable is reduced.

Subsequent Measurement of Promises to Give

- Sometimes a NFP receives a promise to give and the receipt of the assets is not the same as expected.
- The NFP will either record a bad debt or a reduction of revenue

Scenario 1- Change in Collectability

A NFP received a promise to give $10,000 of Home Depot stock on December 20, 20X1 when a share had a market value of $275. This represented 36 shares at that date. On February 2, 20X2 the donor presented $9,720 of Home Depot stock. The value of the shares declined to $270. Since the donor failed to deliver, this would be considered a bad debt.

Scenario 2- Change in FV of Asset Promised

A NFP received a promise to give 36 shares of Home Depot stock on December 20, 20X1 when a share had a market value of $275. This represented approximately $10,000 at that date. On February 2, 20X2 the donor presented the 36 shares of Home Depot stock as promised. The value of the shares declined to $270. Since the donor delivered as promised, this would be considered a reduction of revenue.

Contributions Receivable Accounting Policy

- Unconditional promises to give (pledges) that are to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are initially recorded at the fair value of their **estimated future cash flows** as of the date of the promise to give through the use of a present value discount technique. The discount rate determined at the initial recognition of the unconditional promise to give is based upon management's assessment of many factors, including when the receivable is expected to be collected, the creditworthiness of the other parties, the Council’s, past collection experience and its policies concerning the enforcement of promises to give, expectations about possible variations in the amount or timing, or both, of the cash flows, and other factors concerning the receivables collectability. Amortization of the discounts is included in support from contributions. **An allowance for uncollectible pledges** is recorded when the Council determines, based on historical experience and collection efforts, that a contribution receivable (carried over from a prior year) is uncollectible. As of December 31, 2021 and 2020, contributions receivable were net of an allowance for uncollectible pledges of $X,XXXX.

Naming Opportunities

- May be a contribution or an exchange
- FinREC believes that if public recognition and accompanying rights and privileges result in only nominal value then this is an indication of a contribution.
- Consider:
    - Value of public recognition
    - Length of time that the naming benefit is provided
    - Control over name and logo use
    - Other rights and privileges

Special Events

Revenue from special events

- Could represent an exchange transaction- payment for tickets is measured at the fair value of the direct donor benefits. Any remainder is a contribution
- Exchange portion could possibly be deferred revenue depending on the timing
- Contribution could be a refundable advance depending on timing. The FinREC believes this is a conditional amount if the event is to take place in the next period unless the donor waives the condition.
- Ticket sales would be treated the same way.

Special Events- Example

1. **The costs of direct donor benefits can be deducted from special event gross revenue**

Contributions and Net Revenue from Special Event:		
Contributions		$250,000
Special event revenue	$25,000	
Less: Costs of direct benefits to donors	6,500	18,500
Contributions and net revenue from special events		268,500
Expenses:		
Program		120,000
Management and General		52,000
Fund-Raising		10,000
Total Expenses		182,000
Increase in net assets without donor restrictions		$ 86,500

Two other illustrations in the FASB.

- DDB in expenses
- Revenue broken out between donations and the amount charged for the direct donor benefits (sales/cost of sales)
- Remember that these are exchange transactions and ASC 606 applies

Illustration of Direct Donor Benefits

	Program Services			Management and General	Fundraising and Development	Cost of Direct Donor Benefits	Total
	Advisory	Training	Total				
Grants and other assistance	$ 294,261	$ -	$ 294,261	$ -	$ -	$ -	$ 294,261
Salaries and wages	6,269,754	1,261,585	7,531,339	290,234	184,176	-	8,005,749
Employee benefits	1,198,503	390,865	1,589,368	99,963	21,222	-	1,710,553
Payroll taxes	441,580	94,927	536,507	29,619	9,923	-	576,049
Professional services	1,006,807	87,197	1,094,004	14,980	1,704	-	1,110,688
Accounting fees	-	-	-	40,073	-	-	40,073
Legal fees	-	7,939	7,939	-	-	-	7,939
Advertising and promotion	33,085	21,006	54,091	79,261	79,478	-	212,830
Office expenses	87,071	56,654	143,725	9,867	22,794	-	176,386
Information technology	37,858	706,535	744,393	12,399	14,653	-	771,445
Occupancy	346,601	29,799	376,400	14,918	53,427	-	444,745
Travel	70,957	18,283	89,240	93,292	-	-	182,532
Conferences, conventions and meetings	32,516	76,285	108,801	16,405	-	-	125,206
Meals and entertainment						6,500	6,500
Interest	287,428	-	287,428	-	9,457	-	296,885
Insurance	100,500	12,556	113,056	8,443	930	-	122,429
Training and development	157,617	20,659	178,276	8,113	23,669	-	210,058
Gift shop cost of goods sold	48,621	-	48,621	-	-	-	48,621
Facility rental	-	-	-	-	-	5,000	5,000
Supplies						1,001	1,001
Depreciation and amortization	1,042,663	74,425	1,117,088	20,134	13,960	-	1,151,182
Bad debt expense	-	-	-	16,892	-	-	16,892
Rent expense	31,569	5,977	37,546		7,474	-	45,020
Total expenses by function	**11,487,391**	**2,864,692**	**14,352,083**	**754,593**	**442,867**	**12,501**	**15,562,044**

Contributed Use of Long-lived Assets

- NFPs may receive a promise to give the use of long-lived assets for a period. The donor retains legal title
- These arrangements are similar to a lease but if there is no consideration there is no lease. Donation is the PV of the “rent” of the space but should not exceed the value of the asset. May have donor restrictions
- They may take the form of below market rent. This result in both a lease and a contribution.
- Use fair market rental and deduct the portion that is the lease component. The remainder is the contribution.

Below Market Loans

- NFPs sometimes receive loans of cash that are interest free or have below market rates.
- Entity will record the interest expense and contribution revenue
- Contribution portion will be measured at fair value
- FinREC believes that the difference between the FV and rate of interest at stated rate is an acceptable method of determining the contribution.

Split-Interest Agreements

- Entity receives donation but there are also other parties involved
- May be trustee or not, and with trusts, NFP may be the trustee or trustee may be a 3rd party
- Time period could be a specific period or death of donor
- Generally, the arrangement is irrevocable
- Two main types- lead interest and remainder interest

Split-Interest Agreements

- **Lead Interests-** generally, the donor will establish and fund a trust with specific payments to be made to a designated not-for-profit over a specified period.
- Payments could be fixed (annuity trust) or could be a unitrust where the payments are based on a fixed percentage of the trust's fair value.
- Fair value would be determined each year.
- At the death of the donor or termination of the trust, the remainder is paid to the donor or donor’s designee.
- **Remainder interest-** payments are made to the donor or someone designated by the donor over time and the NFP gets the remainder at the trust termination.

Split-Interest Agreements

- Assets held by the NFP in a charitable gift annuity or in a trust with the NFP as the trustee.
    - Assets at fair value – inception. The remainder or lead interest is calculated using the payments to be made to the beneficiaries based on the document.
    - Subsequent accounting will add to the assets in the trust for return and the liability to the donor is the remaining payments to be made. Discount is amortized. If changes in assumptions of life expectancy those are made.
- NFP is not the trustee. The trustee makes the calculation and reports it to the NFP. NFP has a beneficial interest in the trust instead of the investments and a liability.

Split-Interest Agreements

- **Charitable gift annuity-** held in general asset and liability of NFP. Under charitable gift annuities, the not-for-profit agrees to pay a fixed amount for a specified period of time to the donor, or individuals, or entities designated by the donor. No trust.
- Account for charitable gift annuity in the same way as if the NFP was the trustee.
- Determine the life expectancy of the donor from actuarial tables (not IRS)
- Build a spreadsheet that uses the value of the trust/asset at inception, forecast the payout of the annuity or other payments and the investment income using a forecasted rate. The remainder is the contribution.

Split-Interest Agreements, Example

A NFP museum encourages donors to give through split interest agreements. In 20X1 it entered into a charitable remainder trust where the NFP was the trustee. Under the terms of the agreement, the NFP agreed to pay the donor 5% of the value of the trust for the remainder of her life. At the time of the agreement the donor was 58 years old.

Assets contributed to the trust	$500,000
Age of donor – female	58
Life expectancy according to Society of Actuary tables	84
Payout over time	5% of the net assets of the trust until the donor's death – another 26 years (measured at the beginning of the year).
Expected return on assets	Assume 3.95% average return over time. This assumes that the trust's portfolio has more diversity than just treasuries which pay out at a very low rate. However, it is a prudent return given that this is a trust, which in turn, pays out benefits to a donor. The spreadsheet below could be altered to model various expectations of return and various donors' life expectancies.

Split-Interest Agreements, Example

Estimate of Fair Value of Obligation to the Beneficiary and Museum's Contribution					
Year	Projected Trust Balance Beginning of the Year	Projected Trust Income (3.95%)	Projected Trust Payout (5%) Paid at End of the Year	Present Value Factor	Present Value of Payout
Year 1	500,000	19,750	(25,000)	0.96015	(24,004)
Year 2	494,750	19,543	(24,738)	0.9246	(22,872)
Year 3	489,555	19,337	(24,478)	0.889	(21,761)
Year 4	484,415	19,134	(24,221)	0.8548	(20,704)
Year 5	479,328	18,933	(23,966)	0.8219	(19,698)

All years not shown due to space constraints

Year 24	392,223	15,493	(19,611)	0.3901	(7,650)
Year 25	388,105	15,330	(19,405)	0.3751	(7,279)
Year 26	384,030	15,169	(19,201)	0.3607	(6,926)
		Fair Value of the Donor's Interest			359,313
		Fair Value of the Museum's Interest			140,687

Split-Interest Agreements

- **Pooled Income Fund** - trust where the not-for-profit is a trustee.
- Trust pools the contributions of many donors and invests those gifts as a group.
- Donors are assigned a specific number of units in the pooled income fund based on the proportion of the fair value of their contributions to the total fair value of the pooled income fund on the date of the donor's entry to the pooled fund.
- Until a donor's death, the donor (or the donor's designee) is paid the actual income earned on the donor's assigned units, defined by the agreement.
- When the donor dies, the value of the assigned units belongs to the not-for-profit.

Split-Interest Agreements

- **Perpetual Trust**
- Beneficial interest may be whole or part
- Beneficial interest is a stream of future cash flows. Considered a financial asset since it is expected to be settled in cash.
- The income approach is used to value the perpetual trust.
- If trustee provides the information and has adjusted the value of the trust to fair value, this is the value of the trust.
- If NFP is only entitled to a share of the perpetual trust the proportion is used to estimate the fair value.
- NFPs do not always know that they have an asset so this would be an accounting error if discovered and the payments to the NFP had been paid for prior years.

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