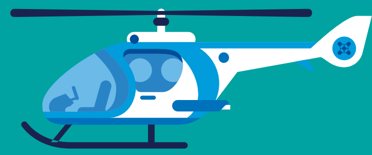
KPMG



# Defining Issues®

## FASB clarifies how not-for-profits and others account for grants and similar transactions

June 25, 2018

KPMG reports on a new ASU[1] that clarifies the scope and accounting guidance for contributions received and made.

### Applicability

All entities that receive or make contributions, which primarily are not-for-profit (NFP) entities, including healthcare entities.

### Key facts

The ASU addresses practice issues by helping an entity evaluate whether it should account for a grant (or similar transaction) as a contribution or as an exchange transaction.

In an exchange transaction, a resource provider receives 'commensurate value' in return for the resources transferred. The ASU clarifies how an entity determines whether a resource provider is receiving commensurate value. The ASU states that benefit to the public, or a benefit that the resource provider gains from carrying out its mission, is not commensurate value.

The ASU also clarifies and expands the criteria for determining whether a contribution is conditional.

Contributions are conditional if the agreement includes:

— a right of return to the contributor of resources transferred or a release of the promisor from its obligation to transfer resources; and

— one or more barriers that must be overcome before a recipient is entitled to the resources transferred or promised.

### Key impacts

Some grants that are considered exchange transactions under current US GAAP will be accounted for as conditional contributions under the ASU. However, the effect of this change may be limited to the net asset classification of grant revenue (and presentation of net assets released from restrictions) for NFPs that do not currently follow or adopt a simultaneous release policy.

Some grants that are considered contributions with no donor-imposed conditions under current US GAAP will be considered conditional under the ASU, which will delay recognition of contribution revenue (recipient) or expenses (resource provider).

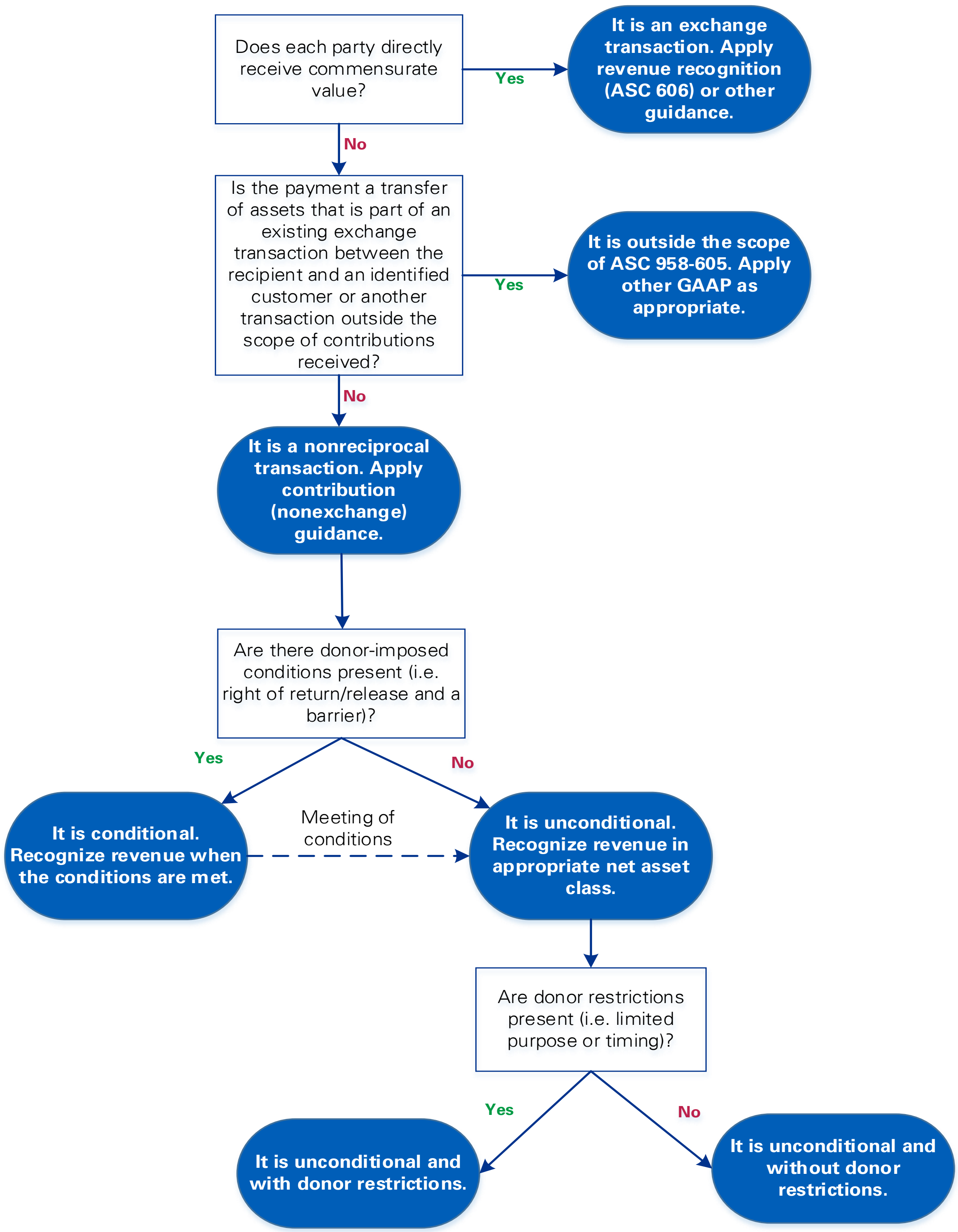
The ASU is intended to reduce diversity in practice and enhance comparability among entities. It will mostly affect NFPs for which grants are a significant source of revenue, and will also affect entities, such as foundations, whose primary activity is making grants.

1 ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made, June 21, 2018

## Analyzing transactions under the ASU

The following flowchart analyzes transactions from a recipient's perspective, however, a resource provider would perform a similar analysis. The flowchart illustrates how to determine whether:

— a transaction is a contribution, an exchange transaction or neither;
— a contribution is conditional; and
— a contribution is donor-restricted.



## Contribution or exchange?

A **contribution** involves a voluntary **nonreciprocal** and unconditional transfer of something of value from one entity to another entity in which the transferring entity is not an owner. The value transferred may be cash or other assets, unconditional promises to give, or a reduction, settlement or cancellation of the receiving entity's liabilities.

In contrast, an **exchange transaction** is a **reciprocal** transaction in which each party receives and sacrifices commensurate value. The ASU provides additional guidance about determining what constitutes **commensurate value**.

The ASU clarifies that benefit to the general public that results from resources transferred to a recipient from the resource provider (including a government agency) would not be evidence that the resource provider received commensurate value. The benefit that the resource provider gains by executing its mission or positive sentiment that it receives by acting as a donor also does not constitute commensurate value.

The FASB's contribution guidance does not apply to transfers of assets from government units to a business entity. However, an NFP must evaluate all transfers, including those from government units, to determine whether they are contributions. An NFP may receive contributions from many sources including private individuals, private foundations, corporate foundations and federal, state and local governments. The type of resource provider does not override the substance of the transaction.

### KPMG observation

There is longstanding diversity in practice in the treatment of grants.

— Many NFPs treat grants from government entities as exchange transactions because they view the benefit to the public as a benefit to the government.

— Some NFPs also treat grants from nongovernment grantors, such as foundations, as exchange transactions but do so because the grant is furthering the grantor's mission and the NFP believes this benefit equals commensurate value.

— In contrast, other NFPs treat the same (or similar) transactions as contributions.

The revenue recognition standard[2] eliminated the exchange transaction guidance in the NFP guidance.[3]

This change caused NFPs that account for certain government and other grants as exchange transactions to reconsider whether these transactions fit the exchange transaction definition and represent activity that should be accounted for under the revenue standard.

By clarifying what is meant by commensurate value, the ASU will reduce diversity in practice and result in many transactions that are accounted for as exchange transactions under current US GAAP being accounted for as contributions under the ASU. NFPs will not be required to call these transactions 'contributions' in the financial statements and could continue to use 'grant' or other relevant terminology.

## Determining whether a transaction is part of an existing exchange transaction

An entity must consider the facts and circumstances when determining whether a transaction represents a payment from a third party as part of an existing exchange transaction between the recipient and an identified customer. This type of transfer is not considered additional revenue by the recipient - i.e. it is neither a contribution nor an exchange transaction.

For example, if the federal government awards a Pell Grant to a student to pay for a portion of the student's tuition at a university, the university recognizes revenue for the full amount of the tuition as a result of its exchange transaction with the student and the payment from the government reduces the university's tuition receivable balance for the student.

[2] ASC 606, Revenue From Contracts With Customers

[3] ASC 958-605, Not-for-Profit Entities—Revenue Recognition

## Determining whether a contribution is conditional

Revenue from conditional contributions is recognized when the conditions on which the contribution depends are substantially met.

Contributions must satisfy two thresholds to be considered conditional under the ASU:

- a right of return to the contributor for the transferred assets (or reduced, settled or cancelled liabilities), or a right of release of the promisor from its obligation to transfer assets (or reduce, settle or cancel liabilities); and
- one or more barriers that must be overcome before the recipient is entitled to the resources transferred or promised.

The agreement does not need to include the specific phrase 'right of return' or 'release from obligation' but the agreement (or another document referenced in the agreement) should be sufficiently clear to support a reasonable conclusion about when the recipient becomes entitled to the resources transferred or promised. In addition, an entity is not required to assess legal enforceability of the right of return or release. The FASB considered but rejected this requirement because this would have added complexity and diversity in practice due to the different laws among jurisdictions.

## Indicators of a barrier to entitlement

The ASU includes a list of indicators to help an entity determine whether an agreement contains a barrier that must be overcome for the recipient to be entitled to the resources. Some indicators may be more significant than others, but the existence of a single indicator does not necessarily mean that there is a barrier to entitlement.

Some agreements also contain multiple barriers that must be overcome before an entity is entitled to the contribution. For example, a federal grant may include both a requirement to incur qualifying expenses and a matching or cost sharing requirement. All barriers must be overcome before the agreement is considered unconditional.

The ASU also eliminates the assessment of 'remote' as a separate step when determining whether a contribution is conditional, and states that a probability assessment is not a factor when determining whether an agreement contains a barrier.

| Indicator of a barrier | Additional details |
|---|---|
| **Measurable performance-related barrier** | This indicator includes situations in which the recipient's entitlement to the resources is contingent upon the achievement of a specified level of service, an identified number of units of output or a specific outcome. |
| **Other measurable barrier** | This indicator includes situations in which the recipient is entitled to the resources if an identified event occurs - e.g. a matching requirement.<br>A resource provider may also specify other measurable barriers that do not require performance by the recipient - e.g. a stipulation that the recipient will not be entitled to the resources unless a certain event occurs or a stipulation that depends on the net worth of the resource provider. |
| **Stipulation related to the purpose of the agreement** | This indicator generally excludes administrative tasks and trivial stipulations. For example, an annual report that serves only administrative purposes would not be an indicator of a barrier. |
| **Limited discretion by the recipient on the conduct of the activity** | This indicator includes stipulations that limit discretion by the recipient on the manner in which the activity can be conducted. These stipulations limit more than the specific activity being conducted by the recipient or the timeframe in which the contribution must be used.<br>This indicator includes requirements to follow specific guidelines about qualifying (allowable) expenses but excludes situations in which the recipient must use the resources for a restricted purpose but has broad discretion on how to use the resources to achieve the intended purpose. |

### KPMG observation

Under current US GAAP, it is often difficult to determine whether a contribution has a donor-imposed condition that affects revenue recognition. If an entity determines that a contribution is conditional, it must also determine whether the likelihood of failing to meet the condition is remote.

Typically, conditional contributions are not recognized until the condition is met, but if the likelihood of failing to meet the condition is deemed remote, the contribution can be recognized immediately.

The remote notion is applied inconsistently today. Some recipients believe that only trivial conditions, such as completing an administrative form, meet this threshold, while others assume that any factor within their control is likely to be met.

Similarly, some resource providers interpret the remote notion as applying to only trivial conditions, while others view most conditions as likely to be met by the recipient (or unlikely to be enforced by the resource provider) given advance due diligence and historical expectations. This inconsistency has resulted in different timing of revenue (and expense) recognition for similar transactions.

The FASB considered requiring an entity to conduct a probability assessment, and only treat the contribution as conditional if the condition is not likely to be met (for the recipient), or the right of return or release from obligation is likely to be enforced (for the resource provider). However, the FASB rejected this approach because it could have continued the diversity in practice that exists today when applying the remote notion.

Instead of a probability assessment, the ASU emphasizes a right of return or release from obligation and barrier(s) to entitlement. These concepts are expected to decrease subjectivity and produce more consistent judgments.

While the ASU indicates that trivial stipulations are not considered barriers to entitlement, removing the remote notion is intended to make clear that neither the resource provider nor the recipient should perform a probability assessment.

The ease with which a barrier may be met or the entity's historical experience with meeting the barrier are not factors to consider when determining whether the contribution is conditional. Revenue (or expense) is recorded based on whether the condition is substantially met, not on whether it is likely to be met.

## Some judgment still required

Given the wide range of resource providers and the different language they use, a recipient will still need to review the wording in each agreement, and if necessary, obtain clarification of intent from the resource provider. A resource provider will also need to ensure that its intent is clearly outlined in its agreements. This will help support its accounting conclusions and the recipient's.

### Distinguishing between promises and intentions to give

Some agreements with donors include intentions to give rather than promises to give. For example, FASB guidance states that solicitations for donations that clearly include wording such as *information to be used for budget purposes only,* or that clearly and explicitly allow the resource provider to rescind its indication that it will give, represent intentions to give and are not promises to give. Therefore, they should not be reported as contributions.

### Distinguishing between barriers and 'best effort' metrics or guidelines

Some resource providers include stipulations in agreements but do not specify that the recipient's entitlement to the contribution depends on the recipient meeting these stipulations. In this case, the resource provider may intend these stipulations to be best effort metrics or guidelines for the activity being conducted. The determination of whether a stipulation results in a barrier is based on whether it affects the recipient being entitled to the transferred or promised resources in the agreement. This assessment may require judgment and in some cases, clarification by the resource provider if the intent is not clear in the grant document.

### Agreements with stipulations that are unclear

The ASU states that if a contribution includes stipulations that are ambiguous and the ambiguity cannot be resolved by reviewing the facts and circumstances and communicating with the donor, the contribution should be presumed to be conditional unless the stipulation is not related to the purpose of the agreement. However, agreements that contain either a right of return or release from obligation, but include no barriers to entitlement, are unconditional.

## Simultaneous release option

NFPs are permitted to report as without donor restrictions[4] donor-restricted contributions whose restrictions are met in the same reporting period as the revenue is recognized. However, under current US GAAP, an NFP electing this policy for contributions must apply it to all contributions and investment returns. The ASU amends US GAAP to permit NFPs to bifurcate this policy and elect it for donor-restricted contributions that were initially conditional without electing it for other donor-restricted contributions and investment returns.

Many conditional contributions, (e.g. restricted government grants that require the recipient to incur qualifying expenses) include stipulations where the condition is met (i.e. revenue is recognized) and the restriction satisfied at the same point in time. The FASB decided to permit NFPs to report these contributions as without donor restrictions without changing how they report other donor-restricted contributions and investment returns. An NFP adopting this policy for all donor-restricted contributions or only those that were initially conditional should report consistently from period to period and disclose its policy.

**KPMG observation**

The guidance about determining whether a transaction is an exchange transaction or a contribution and whether a contribution is conditional applies equally to resources received by a recipient and those provided by a resource provider. Some entities that receive contributions also make contributions using their own resources or, in some cases, they may award a portion of grant funds received to other parties.

When assessing whether amounts passed through from federal grants to a secondary recipient are exchange transactions or contributions, an entity should coordinate this analysis with its analysis about whether the secondary recipient is a contractor or subrecipient under federal guidelines. While the criteria are different, an entity will need to ensure that its consideration of the grant agreement and underlying relationship with the secondary recipient is consistent under both analyses.

## Disclosures about conditional promises to give

The ASU does not include any additional recurring disclosures. While the requirements are unchanged from current US GAAP, we expect that on the adoption of the ASU, the population of promises that these disclosure requirements apply to will significantly increase for many entities.

| Recipients | Resource providers |
|---|---|
| Disclose the total amounts promised, and provide a description and amount of each group of promises with similar characteristics, such as the amount of promises conditioned on establishing new programs, completing a new building or raising matching gifts by a specified date. | There are no specific disclosure requirements about conditional promises to give for resource providers.<br>However, US GAAP on contingencies and debt includes relevant requirements.[5] |

[4] Terminology used in this document is based on US GAAP post-adoption of ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities

[5] ASC 450, Contingencies; and ASC 470, Debt

**Example: Grant accounted for as an exchange transaction under current US GAAP is now a conditional contribution under the ASU**

**Background**

- University A was awarded a 3-year grant from the National Institutes of Health (NIH) to fund diabetes research.
- The terms of the grant specify that University A must incur certain qualifying expenses in compliance with all relevant regulations established by the NIH, the Department of Health and Human Services and the Office of Management and Budget.
- University A retains the rights to research findings and forfeits funds not used within 3 years.

**Analysis under current US GAAP**

- University A concludes that the NIH receives commensurate value through the societal benefit to the public from the research.
- University A accounts for this grant as an exchange transaction and records revenue without donor restrictions as it incurs expenses.

**Analysis under the ASU**

- University A concludes that the NIH does not receive commensurate value because societal benefit to the public does not represent value to the NIH. University A concludes that this transaction is a voluntary, nonreciprocal transaction that meets the definition of a contribution.
- The grant's specific requirements on how University A may spend the assets (i.e. incurring certain qualifying expenses under the federal regulations) limits University A's discretion on how it conducts the research. The agreement releases the NIH from its obligation to pay University A if the University does not incur qualifying expenses within the 3-year period. University A concludes that this grant is a conditional contribution.
- The contribution is donor-restricted because its use is limited to conducting diabetes research, which is narrower than University A's purpose, the environment in which it operates, or the purposes specified in its articles of incorporation or bylaws.
- University A records grant revenue with donor restrictions as it incurs qualifying expenses. At the same time, University A records net assets released from restrictions because incurring the qualifying expenses on diabetes research fulfills this restriction.
- Alternatively, if University A has an existing policy to report as without donor restrictions contributions and investment return whose restrictions are met in the same reporting period (or creates this policy only for conditional contributions), it would record the NIH grant revenue as grant revenue without donor restrictions as it incurs qualifying expenses. There would be no release from restrictions.

**Example: Contribution accounted for as unconditional under current US GAAP is now conditional under the ASU**

**Background**

- NFP A is awarded a 2-year $100,000 grant from Foundation X to provide meals to children and single mothers in need.
- The grant requires NFP A to use the funds, which are paid in advance, to provide 200,000 meals. The agreement specifies that there is a pro rata right of return for meals not served within the 2-year period.

**Analysis under current US GAAP**

- NFP A concludes that this transaction is a voluntary, nonreciprocal transaction that meets the definition of a contribution. Any benefit gained by Foundation X from furthering its mission through the grant to NFP A is not deemed commensurate value. NFP A routinely serves 1 million meals annually to children and single mothers in need. While NFP A views the requirement to serve 200,000 meals as a condition, the likelihood of not meeting the condition is deemed remote and NFP A concludes that the contribution is not conditional.
- Because the grant is limited to providing meals, NFP A concludes that the contribution is donor-restricted as this restriction is narrower than NFP A's overall mission, which is to provide meals, housing and other services to children and single mothers in need.
- NFP A records contribution revenue for $100,000 in the with donor restrictions net asset class when it receives the grant agreement and net assets released from restrictions when it meets the restrictions.
- Foundation X separately analyzes the transaction and concludes, similarly to NFP A, that Foundation X has made a contribution that is not conditional. Foundation X records grant expense when it communicates the grant award to Foundation X.

**Analysis under the ASU**

- NFP A concludes that the requirement to provide 200,000 meals is a measurable barrier that must be overcome for NFP A to be entitled to the funds. The agreement also includes a right of return. NFP A concludes that this grant is a conditional contribution.
- NFP A maintains its conclusion that the contribution is donor-restricted.
- NFP A records a liability for any funds received in advance. NFP reduces the liability and records contribution revenue in the with donor restrictions net asset class as the meals are served - i.e. pro rata as it overcomes the barrier. At the same time, NFP A records net assets released from restrictions because serving the meals would fulfill the purpose restriction. Alternatively, NFP A may use the simultaneous release policy discussed in the previous example.
- Foundation X separately analyzes the transaction and concludes, similarly to NFP A, that Foundation X has made a conditional contribution. Foundation X records an asset (e.g. prepaid grants) as it distributes funds to NFP A. Foundation X reduces the asset and records grant expense based on the number of meals served by NFP A (and reported to Foundation X) each reporting period.

## Effective dates

| | Recipient transactions (revenue) | | Resource provider transactions (expense) | |
|---|---|---|---|---|
| | Public[1] NFPs and public business entities | All other | Public[1] NFPs and public business entities | All other |
| Annual periods – in fiscal years beginning after | June 15, 2018 | Dec. 15, 2018 | Dec. 15, 2018 | Dec. 15, 2019 |
| Interim periods – in fiscal years beginning after | June 15, 2018 | Dec. 15, 2019 | Dec. 15, 2018 | Dec. 15, 2020 |
| Early adoption | Permitted | | | |

[1] 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.

## Transition approaches and disclosures

| Modified prospective | Retrospective |
|---|---|
| Apply the ASU in the first set of financial statements after the effective date to all agreements that are either: (1) not completed at the effective date; or (2) entered into after the effective date.<br>— Completed agreements are those for which all revenues (of a recipient) or expenses (of a resource provider) have been recognized.<br>— Apply the ASU only to the portion of revenue or expense that has not yet been recognized at the effective date.<br>— There is no restatement of prior-period results or cumulative effect adjustment to opening net assets or retained earnings at the beginning of the year of adoption. | Apply the ASU to each period presented in the financial statements.<br>— Reflect the cumulative effect in the carrying amounts of assets and liabilities as of the beginning of the first period presented.<br>— Adjust opening net assets or retained earnings for the cumulative effect for that period.<br>— Restate prior period results. |
| In the first interim and annual period of adoption disclose the:<br>— nature of, and reason for, the change in accounting principle; and<br>— reasons for significant changes in each financial statement line item in the current reporting period resulting from applying the ASU. | In the first interim and annual period of adoption disclose the:<br>— nature of, and reason for, the change in accounting principle; and<br>— the method of applying the change including:<br>  — a description of the prior-period information that has been retrospectively adjusted, if any; and<br>  — the effect of the change on relevant financial statement line items including opening net assets or retained earnings. |

**Contributing authors**
Lisa C. Hinkson; Amanda E. Nelson

**KPMG's Financial Reporting View**
kpmg.com/us/frv

**kpmg.com/socialmedia**