Case Studies in Revenue Recognition for Not-for-Profits

NCACPA Mountain Cluster
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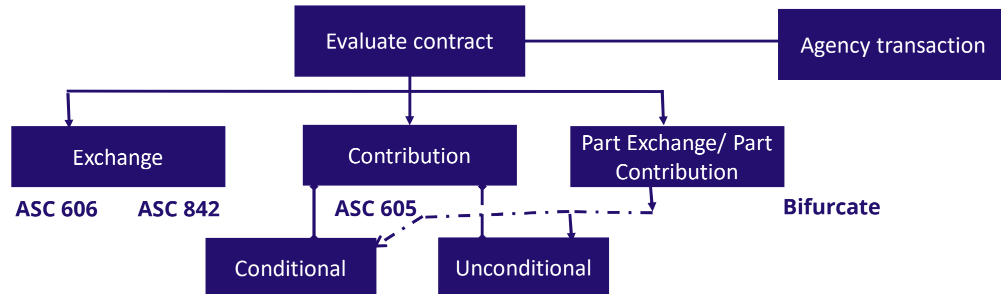
KAPLAN

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.

Indicators of Exchange or Contribution

Exchange	Contribution
Expressed intent of both parties is to exchange goods/services for resources of commensurate value	Recipient solicits assets but intends no reciprocal value
Both parties agree on the amount of assets exchanged	The resources provider has the discretion on how much is provided
Contractual provisions provide for the assessment of penalties beyond the assets provided in the case of nonperformance	Penalties are limited to resources provided

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 in the contract

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

Tuition and Housing – Case Study 2

Case Study

A student is accepted into a college. The tuition and housing for the period is $10,000. The nonrefundable deposit that the student must pay is credited back to the account if the student enrolls. If the student does not attend class, they do not get their deposit back. If the student decides they want to drop a class, they have 2 weeks at the beginning of the period to do so. They are issued a prorata refund for the tuition for that class (except the portion that is the nonrefundable deposit)

Student A enrolls and decides (within the grace period) that they want to drop one class which represents 10% of the tuition). This does not include the nonrefundable deposit. Student A attends class but does not pay the tuition until the second week is over. Tuition was due 2 weeks before class starts.

Student B decides to go to another college and never enrolls.

Tuition and Housing – Case Study 2

Tuition and Housing Revenue

Step 1: Identify the contract. Entity will need to consider the practices and processes including the admission and registration processes, in determining whether and when an agreement with a student has enforceable rights and obligations between the parties.

- A contract **does not exist** if each party has the unilateral, enforceable right to terminate a wholly **underperformed** contract without compensating the other party.
- There are two circumstances where a contract would be underperformed if both criteria are met.
  1. The entity has not transferred promised goods or services
  2. The entity has not received and is not yet entitled to receive consideration in exchange for the goods or services.

Tuition and Housing – Case Study 2

Tuition and Housing Revenue

Step 1: Identify the contract (con't)

- IHEs will need to determine whether consideration has been received from or on behalf of the student, whether the entity is entitled to receive consideration in exchange for promised services **or** if the IHE has begun to perform the services.
- Any of these circumstances would indicate that the contract is **not** wholly underperformed.

Collectability- To determine if there is a contract the entity will assess collectability

- Probable that the entity will collect the consideration it is entitled to under the contract
- Entity will look at the customer's ability and intention to pay the consideration when due
- Amount of consideration to which the entity is entitled to could be less than the price in the contract if the consideration is variable because the entity could offer a price concession

Tuition and Housing – Case Study 2

Tuition and Housing Revenue

Collectability

- If collectability is not probable and there is no contract and an entity receives consideration from the customer the consideration is recognized only when one of the following events occurs
    - Entity has no remaining obligations to transfer goods or services to the customer and substantially all of the consideration promised by the customer has been received by the entity and is nonrefundable
    - The contract has been terminated and the consideration received from the customer is nonrefundable
    - The entity transferred control of the goods or services for which consideration has been received and the entity stopped transferring goods or services to the customer and has no further obligation under the contract to transfer goods or services and the consideration received is nonrefundable

Tuition and Housing – Case Study 2

Tuition and Housing Revenue

Combining Contracts

- The IHE will need to determine if it has one or more contracts.
- ASC 606 states that an entity shall combine two or more contracts entered into at or near the same time with the same customer and account for it as one contract if one or more criteria are met.
  - Contracts are negotiated as a package with single commercial objective
  - The consideration paid in on depends on the price or performance of the other
  - If the services performed are a single performance obligation
- The IHE would need to consider whether a discount, such as financial aid was provided in a bundled arrangement. But if none of the criteria are met then there is a single performance obligation.

Tuition and Housing – Case Study 2

Tuition and Housing Revenue

Portfolio Approach

- Practical expedient performance obligations with similar characteristics can be evaluated together if the entity believes that applying the guidance to a portfolio of transactions would not differ greatly from a contract-by-contract approach

Case Study Application of Step 1

- College evaluates the arrangements with Students A and B and since it believes the amounts are collectible they believe a contract is present.
- College has thousands of similar contracts and uses the portfolio approach for them.

Tuition and Housing – Case Study 2

Step 2: Identify the Performance Obligations

- IHEs need to determine if tuition and housing are separate performance obligations.
- If services are distinct then the performance obligations are separate.
  - A good or service is distinct if the customer can benefit from the service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or services to the customer is separately identifiable from other promises in the contract.
- IHEs need to determine the promises included in the contract(s) entered into with students and whether the promises are performance obligations that should be accounted for separately.
- The FinREC believes that in most cases theses services are distinct performance obligations.

Tuition and Housing – Case Study 2

Determine Performance Obligations

Case Study Application of Step 2

- Tuition is deemed one performance obligation and housing another. These are distinct goods and service. The FinREC believes this is generally the appropriate position.

Tuition and Housing – Case Study 2

Step 3: Determine the Transaction Price

- The IHE will need to determine the transaction price.
- Consider the terms of the contract as well as their business practices.
  - The transaction price is the amount of consideration the entity expects to be entitled to for the good or services delivered.
  - Excludes amounts collected on behalf of their parties. It includes fixed amounts as well as variable amounts.
- Consideration payable to the customer discounts, vouchers or other credits
  - Reduction in transaction price
- Right to withdraw – variable consideration must be estimated

Tuition and Housing – Case Study 2

Step 3: Determine the Transaction Price

- Collectability is assessed at Step 1.
- Consideration, including variable consideration, is determined at Step 3.
- Transaction price is not adjusted for credit risk in Step 3 unless the contract has a significant financing component. IHE would use a rate commensurate with the credit risk involved.
- Evaluate all contract assets and receivables or impairments.
- Judgement is required in evaluating whether the contract is impaired or whether the student has been given a price concession.
- Customary business practices.

Tuition and Housing – Case Study 2

Case Study Application of Step 3: Determine the Transaction Price

College believes they will be paid $10,000 ($1,000 comes in to signal a transaction).

- Nonrefundable deposit absorbs the first 2 weeks of tuition since that is the period that is the grace period.
- On a portfolio basis the College will evaluate the withdrawals from classes representing refunding of tuition.

The student enrolls and the deposit is included in the transaction price. But since the IHE is not entitled to it, the payment is reflected as a contract liability or deferred revenue.

	Debit	Credit
DR Cash	**$1,000**	
CR Contract liability (deferred revenue)		**$1,000**

To reflect payment to the IHE of the deposit.

Tuition and Housing – Case Study 2

Step 4: Allocate the Transaction Price to Performance Obligations

- In cases where there is a contract with more than one performance obligation (tuition and housing) the IHE will need to allocate the amount to each performance obligation in an amount that represents the consideration that represents the stand alone selling price
- This is the observable price that that the entity sells the service for separately

Case Study Application of Step 4:
The IHE sells the tuition without housing after the first year. Therefore, they have something distinct and measurable and can estimate the housing by calculating the remainder.

Tuition and Housing – Case Study 2

Step 5: Recognize Revenue When (or as) the Entity Satisfied a Performance Obligation

- FinREC believes that in the case of tuition and housing the IHE satisfies the obligation over the academic period so recognizing revenue over time is appropriate.
- The student is simultaneously receiving and consuming the benefits provided under the contract.
- Student does not attend class, IHE recognizes revenue over the grace period.
- If a student does not enroll or move into the housing and has paid a nonrefundable deposit, then at that point the IHE recognizes the amount as revenue. This would happen when the right to enroll or commit to housing expire.

Tuition and Housing – Case Study 2

Step 5: Recognize Revenue When Performance Obligations are Met

Revenue is recognized over time (academic period). The invoice is sent to the student. **No entry** is made because the semester has not started so the entity has no right to the revenue yet.

Payment is due 2 weeks before class begins. **No entry** is made because the student may cancel the contract during the withdrawal period

Classes start. Student has made no payment except the deposit.

DR Contract liability (deferred revenue) $91
CR Revenue $91

To recognize revenue less refund estimate ($10,000/100 days less ($9,000/100 days) X 10%). This occurs for the 10 days during the withdrawal period. 10% is the estimated withdrawal rate.

Tuition and Housing – Case Study 1

Case Study Application of Step 5: Recognize Revenue

- Student drops one class and the reduction of the transaction price is $900. But the only revenue that has been recognized is due the entity anyway because it is the nonrefundable deposit. The remainder has been billed but not recorded. The new tuition bill is $8,100. **No additional entry.**
- The withdrawal period ends.

DR Receivable $8,100
CR Contract Liability (deferred revenue) $8,100
To reflect the receivable for the unpaid balance.

Tuition and Housing – Case Study 2

Journal Entries for Case Study

- The semester continues and revenue is recognized ratably over the period at $91 per day X 90 days remaining.

DR Contract liability (deferred revenue) $8,190
CR Revenue $8,190
To reflect the receivable for the unpaid balance.

- The student pays the bill.

DR Cash $8,100
CR Receivable $8,100
To reflect the receivable for the unpaid balance.

Revenue Recognition Reminders

- Unconditional rights to consideration are presented separately as a receivable. This would be appropriate if the only condition to satisfying the obligation was the passage of time.
- Even though ASC 606 discusses contract assets and liabilities as terms in the literature, alternative terms are acceptable.
- Advance cash payments represent contract liabilities.
- Amounts that represent consideration to which the entity has a right are receivables.
- If the entity provides services before payment, then this is a contract asset. Evaluate for impairment.
- It is not permissible to show revenue as gross when there are discounts and allowances.
- FinREC -acceptable for the IHE to disclose the amounts of the reductions incorporated in the revenue line. This could be done on the face of the statement or in the footnotes.

Membership Issues- Case Study 3

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 Issues- Case Study 3

- 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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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 Issues- Case Study 3

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	

Membership Issues- Case Study 3

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.
- The entity's performance creates or enhances an asset that the customer controls
- 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.

Membership Issues- Case Study 3

Step 5: Recognize Revenue when or as Performance Obligations are Satisfied – At Time Control Passes

- If the performance obligation is not satisfied over time, the membership organization should consider at what point in time control transfers, based on the following indicators:
  - Present right to payment
  - Legal title
  - Physical possession
  - Risks and rewards of ownership
  - Customer acceptance

Membership Issues- Case Study 3

- **Step 5 Analysis:** The original visit has a fair value of $75. The FrightNight 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.

Membership Issues- Case Study 3

C. A trade association provides advocacy, a hotline for members to ask questions, networking events (members only) and a quarterly journal which is also sold to others for $20 an issue.

Membership benefits are delivered over time. The journal is mailed quarterly.

Analysis:

Performance Obligations (PO)	**Value**	**Proportion**
Journal Quarter 1	$ 20.00	8.70%
Journal Quarter 2	$ 20.00	8.70%
Journal Quarter 3	$ 20.00	8.70%
Journal Quarter 4	$ 20.00	8.70%
Membership benefits	$ 150.00	65.22%
Observable prices for Pos	$ 230.00	100.00%
Allocate to POs based on contract price	**$ 200.00**	
Journal Quarter 1	$ 17.39	
Journal Quarter 2	$ 17.39	
Journal Quarter 3	$ 17.39	
Journal Quarter 4	$ 17.39	
Membership benefits	$ 130.43	

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.

Contract Balances

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

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

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.

Revenue Recognition- Example Disclosures

Following are excerpts from the Local Council, Inc., Boy Scouts of America’s Notes to the Consolidated Financial Statements for the years ending December 31, 2021 and 2020.

This first set is related to revenue and accounts receivable from exchange transactions.

Accounts Receivable- Accounting Policy

Accounts Receivable

Accounts receivable are recorded primarily for popcorn (product) sales and are reported at net realizable value if the amounts are due within one year. An allowance for doubtful accounts is based on an analysis of expected collection rates determined from experience. No allowance for doubtful accounts was considered necessary as of December 31, 2021 and 2020.

Accounts Receivable- Footnote

NOTE 4—ACCOUNTS RECEIVABLE

Accounts receivable consist primarily of amounts due from Scout units on popcorn sales and totaled $XXXX and $XXXX as of December 31, 2021 and 2020, respectively. Allowances for doubtful accounts are established based on prior collection experiences and current economic factors, which, in management's judgment, could influence the ability of customers to repay the amounts. No allowance for doubtful accounts was deemed necessary as of December 31, 2021 and 2020.

At December 31, 2021, the Council also recorded in its financial statements $XXX due from filing Forms 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, in order to receive amounts to which it believes it is entitled under the Employee Retention Credit (ERC), which is a refundable credit against certain payroll taxes allowed to an eligible employer for qualifying wages, that was established by the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* and further amended by the *Consolidated Appropriations Act (CAA)* and the *American Rescue Plan (ARP)*. Laws and regulations concerning government programs, including the Employee Retention Credit, are complex and subject to varying interpretations. Claims made under the CARES Act may also be subject to retroactive audit and review. There can be no assurance that regulatory authorities will not challenge the Council's claim to the ERC, and it is not possible to determine the impact (if any) this would have upon the Council.

Deferred Revenue Footnote

NOTE 9—DEFERRED REVENUE

The activity and balances for deposits and deferred revenue from contracts with customers are shown in the following table:

	Camps	Activities	Special Events	Other	Total
Balance at December 31, 2019	$X,XXX	$X,XXX	$X,XXX	$X,XXX	**$X,XXX**
Revenue recognized	(X,XXX)	(X,XXX)	(X,XXX)	(X,XXX)	**(X,XXX)**
Payments received for future performance obligations	X,XXX	X,XXX	X,XXX	X,XXX	**X,XXX**
Balance at December 31, 2020	X,XXX	X,XXX	X,XXX	X,XXX	**X,XXX**
Revenue recognized	(X,XXX)	(X,XXX)	(X,XXX)	(X,XXX)	**(X,XXX)**
Payments received for future performance obligations	X,XXX	X,XXX	X,XXX	X,XXX	**X,XXX**
Balance at December 31, 2021	**$X,XXX**	**$X,XXX**	**$X,XXX**	**$X,XXX**	**$X,XXX**

Revenue Recognition Policy Note

Revenue from Exchange Transactions: The Council participates in exchange transactions with customers that are bound by contracts or similar arrangements and establishes a performance obligation approach to revenue recognition. The Council records the following exchange transaction revenue in its (consolidated) statements of activities and changes in net assets for the years ending December 31, 2021 and 2020:

Scout Shop and Trading Post sales—The Council operates a Scout Shop in its Service Center and various Trading Posts at its summer camp(s), which sell Scouting-related merchandise on a retail basis to customers. The performance obligation is the delivery of the good to the customer. The transaction price is established by the Council based on retail prices suggested by the suppliers. As each item is individually priced, no allocation of the transaction price is necessary. The Council recognizes revenue as the customer pays and takes possession of the merchandise. Some merchandise is sold with a right of return. If probable customer returns exist at the end of an accounting period, the Council estimates and records in its financial statements a liability for such returns, which offsets revenue. No liability for probable customer returns was considered necessary as of December 31, 2021 and 2020.

Revenue Recognition Policy Note (con't)

Product sales—To help Scout packs and troops raise the money they need to fund programs and activities throughout the year, the Council participates in the Trail's End Popcorn program. Scout packs and troops purchase popcorn from the Council, which they then resell to customers. The Scout packs and troops earn a commission of _____% on each sale they make, which may be used to offset the price of the popcorn they purchase from the Council (if applicable). The popcorn sale also helps the Council raise money in support of its programs. Popcorn sales to Scout units start in the fall of each year, with the units placing their orders online through the Trail's End website. The price the Scout unit pays for the popcorn is established by the Council, and each item is individually priced, so no allocation of the transaction price is required. Many BSA units are allowed to purchase popcorn "on account". The Council assesses the probability of collecting these accounts receivable to determine whether there is a substantive transaction between the council and the unit. In making this collectability assessment, the Council exercises judgment and considers all facts and circumstances, including its knowledge of the customer. The Council uses the Trail's End website to track and manage unit accounts receivable.

With popcorn sales, the performance obligation is delivery of the product, which is fulfilled by the Council at predetermined times and locations. Revenue recognition occurs when the product has been delivered. The Council presents separately in its (consolidated) statements of activities and changes in net assets gross revenues from popcorn sales, cost of goods sold, and unit commissions (retained by or paid to the unit).

Scout units have the right to return to the Council any unsold product, subject to a return-by date of (___________). As of December 31, 2021 and 2020, no probable popcorn returns existed. Accordingly, no liability for probable customer returns was considered necessary.

Grants and Contributions

- Master Glossary
  - "In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit, although the benefit is not considered to be of commensurate value. In an exchange transaction, the potential public benefits are secondary to the potential direct benefits to the resource provider."

Grants and Contributions

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)
- 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.

Grants and Contributions

- 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.
- If there is no indication that an NFP is only entitled to the transferred assets or a future transfer of assets if it has overcome a barrier the transaction is deemed to be a **contribution** without donor-imposed conditions.

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- Case Study 4a

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- Case Study 4b

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- Case Study 5

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- Question for Discussion

A social service research collaborative focusing on diversity and similar issues received grant funding in the amount of $3 million. The grant funds are payable in 3 large installments with the smaller last installment at the end of the grant period. Grant funding may be required to be returned if:

Grantee ceases to qualify as 501(c)(3)

Grantee does not submit satisfactory reports on time

Grantee fails to perform duties as specified

Grantee is unable to fulfill purpose of grant (including insolvency) or significant unexpended funds (grantor determination)

The grant funds may only be spent for budgeted expenses. Budget reallocations must be approved in advance if greater than 25% of the budgeted line item. The grant requires the not-for-profit to produce one research report each quarter and hold an annual meeting to present research findings along with completing several other tasks as listed in an attached timetable.

Is this a conditional or unconditional contribution?

Grants and Contributions- Case Study 6

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

Conditional Contributions- Disclosure

From the Summary of Significant Accounting Policies

Conditional promises to give are not recognized in the financial statements until the conditions are substantially met or explicitly waived by the donor. During the years ended June 30, 20X1 and 20X0 the Organization received the following conditional promises to give that are not recognized as assets in the statements of financial position.

		20X1	20X0
Conditional promise to give upon the establishment of a library program		1,054,530	900,000
Conditional promise to give upon obtaining $25,000 in unconditional promises to give to the campital campaign		50,000	

The Organization received an indication of an intention to give $500,000 from an individual long-time donor at the time of their death. The value of this intended gift has not been established nor has the gift been recognized in the financial statements.

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- Case Study 7

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.

Contributed Nonfinancial Assets- Valuation

- Level 1 -a quoted price (unadjusted) in an active market for an identical asset or liability that the reporting entity can access at the measurement date.
- If no active market, then look for level 2 inputs.
- May be publicly available information about transactions for the identical or similar items on inactive markets, like auction websites
- In other cases, the only transactions for the contributed item occur in principal-to-principal markets with little information that is publicly available.
- FinREC notes that is when the not-for-profit will need to determine fair value by making its own assumptions (level 3 input).
- Not-for-profit will consider relevant factors specific to situation

Contributed Nonfinancial Assets- Case Study 8

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. In evaluating the principal market, the NFP would not use retail pharmacy sales prices. They are not able to sell in that market. 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

- Sometimes issues arise when the NFP may have other reasons for not pursuing highest and best use.
- Tax law or 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.
- ASC 820 notes that the highest and best use of a nonfinancial asset considers the use of the asset that is physically possible, legally permissible, and financially feasible.

Contributed Nonfinancial Assets- Case Study 9

A not-for-profit entity received the gift of land that had a conservation easement on it. The CFO, considered the characteristics of the asset when estimating fair value. He considered the such as certain legal restrictions on sale or use knowing that a market participant would take those characteristics into account when pricing the asset at the measurement date. Easements, which are recorded like a deed and are binding upon future owners of the property, should be considered in valuing the asset since the donor placed that restriction on use of the property.

Contributed Nonfinancial Assets

- If the not-for-profit receives an appraisal they should challenge it, without bias, to determine whether it is appropriate.
- There are published sources that exist that provide values of various assets that may be received vehicles.
- The FinREC believes that the entity should consider whether those published sources are appropriate inputs for measuring fair value.
- The value that a donor recognizes for tax purposes may differ significantly from fair value.

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.

Contributed Nonfinancial Assets- Case Study 10

A humane society received week stay at a luxury resort with a fair value of $2,500 from a donor. This trip was auctioned to the highest bidder. There was a lag between the time of the original donation and the fundraising event so that original donation took place in 20X1 and the fundraiser in 20X2. The initial donation was reported as a $2,500 contribution with donor restriction and the gift reported as an asset. At the fundraiser the trip sold for $6,000. The additional $3,500 was reported in 20X2. No cost for the ticket was reported on the statement of activities.

Note that in the example above, if the trip had sold for $2,000 then a reduction of revenue would have been recorded.

Contributed Nonfinancial Assets

- Q&A 6140.24- when nonfinancial assets are used for a NFP's benefit or provided to them free of charge to help the entity with fundraising or communication, the entity should consider whether it has received a contribution.
- The FinREC - in the case of advertising, and media time or space, the NFP should record a contribution if the not-for-profit has an active involvement in determining and managing the message and the use of the materials.
- NFP's involvement in determining and managing the content does need not be absolute in order to conclude that a contribution has been received.

Contributed Nonfinancial Assets- Case Study 11

A not-for-profit arts organization received advertising time from a local TV station. As part of the donation the TV station helped the not-for-profit in creating the advertising spot. In addition, the not-for-profit was not given a choice as to when the advertising would be played. The controller determined that these two factors would not be an issue in reporting this as a donation since the not for profit was determining the content.

Question for Discussion: If the NFP would not have purchased it should the entity record the advertising as a donation?

Contributed Nonfinancial Assets

- First effective for not-for-profits – June 30, 2022 year ends, Retrospective application is required.
- Nonfinancial assets or services.
- FASB expressed concern that there was insufficient information in the financial statements to allow the user to assess the entity's dependence on those gifts.
- Many not-for-profits fail to value nonfinancial assets.
- Generally, no impact on net assets.

ASU 2020-07, Contributed Nonfinancial Assets

- ASU-2020-07 is strictly a disclosure requirement.
- Prior standard required the entity to disclose information about contributed services the nature and extent of the services received for the period and the amount recognized as revenues for the period. (still required)
- The guidance encouraged the disclosure of the fair value of contributed services received but not recognized as revenue if practicable.
- Recognition of contributed services
- Not-for-profits are encouraged to disclose the fair value of contributed services received, but not recognized as revenues if that is practicable.

ASU 2020-07, Contributed Nonfinancial Assets

- Typically, the entity includes a sentence stating that the entity receives donated services from volunteers that do not meet the revenue recognition criteria.
- Number of volunteer hours unless monetary information was available.
- Disclosure of contributed services is required regardless of whether the services received are recognized as revenue in the financial statements.
- ASU 2020-07 did not alter those requirements.

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

- ASU 2020-07 allows some leeway in presentation.
- While the information is required to be broken out on the statement of activities the captions may vary.
- FASB has noted in presentations that there could be a separate column where contributions of nonfinancial assets are listed.
- If the entity wanted to it could list the types of nonfinancial assets in the statement activities instead of in the footnotes.

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.
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 if it is a market in which the entity is prohibited by donor restrictions from selling or using the contributed nonfinancial asset.	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 and 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.

Nonfinancial Assets- Accounting Policy

Donated Materials and Services (From Boy Scout of America Consolidated Financial Statements)

Donated land, buildings, equipment, investments, and other noncash donations are recorded as contributions at their fair market value at their date of donation. The Council reports the donations in the net assets without donor restrictions category, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets must be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported in the net assets with donor restrictions category. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Council reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Donated services are recognized as contributions if the services (a) create or enhance nonfinancial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by the Council. Some members of the Council have donated significant amounts of time to the Council in furthering its programs and objectives. However, no amounts have been included in the consolidated financial statements for donated member or volunteer services since they did not meet the criteria for recognition (if this is the case for your council).

Intentions vs. Promises to Give

- Sometimes it is unclear whether there is an intention to give (conditional) or a promise to give (unconditional)
- Wills- FinREC believes this is an **intention** to give. When the probate court declares the will valid a receivable may be recognized
  - Generally, amounts will not be considered donor restricted unless there are purpose restrictions
  - Conditional promises should be disclosed
- If donor communicates a promise that on date of death that a contribution of $X will be given to the entity then FinREC believes that this is a promise to give.
  - The possibility that the assets could be depleted or some other occurrence does not negate the promise.

Intentions vs. Promises to Give- Case Study 12

- Unconditional promise to give at death (or period in the future)
  - Evaluate that the way a long-term pledge would otherwise be valued
  - Consider whether sufficient assets will exist to fulfill the promise, anticipated date of distribution, whether the NFP is the beneficiary of a trust

Case Study: A CFO of a religious organization wanted to raise money for an endowment fund. A letter was sent to the parish asking them to remember the organization in their wills. Several parishioners indicated interest and the CFO was faced with these were intentions to give or promises to give. For the organization to record them, they needed to be promises to give. He worded a pledge document so that the donor was promising $X on the date of death. The second issue was, how to value them. He evaluated the life expectancy of the donors using tables from the Society of Actuaries and then evaluated the expected cash flows based on their financial situations. The FinREC noted that the risk premium for bearing uncertainty would be higher for a 29-year-old of modest means than for a wealthy 89-year-old.

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

Case Study 13- Fair Value of Contributions Receivable

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 six 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%

Case Study 13- 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 on 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%

Case Study 13- 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%

Case Study 13- 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 so as 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]						

Case Study 13- 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.

Promises to Give- Example Disclosure

Note D – Promises to Give

Unconditional promises to give are estimated to be collected as follows at June 30, 20X1:

Within one year	*$ 759,572*
In one to five years	*622,072*
Over five years	*165,000*
	1,546,644
Less discount to net present value at rates ranging from 2.96% to 3.50%	*(122,994)*
Less allowance for uncollectable promises to give	*(145,539)*
	$ 1,278,111

Promises to give appear as follows in the statement of financial position:

Promises to give, net	*$ 941,112*
Endowment promises to give, net	*336,999*
	$ 1,278,111

At June 30, 20X1, three donors accounted for 47% of total promises to give. Two contributors accounted for approximately 31% of total contribution revenue for the year ended June 30, 20X1.

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.

Contributions Receivable- Footnote

NOTE 5—CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following as of December 31, 2021 and 2020:

	2021	2020
United Way	$X,XXX	$X,XXX
Friends of Scouting	X,XXX	X,XXX
Foundations	X,XXX	X,XXX
Other - without donor restrictions	X,XXX	X,XXX
Restricted to capital campaign	X,XXX	X,XXX
Restricted to Endowment Fund	X,XXX	X,XXX
Total	**$X,XXX**	**$X,XXX**
Contributions receivable due in less than one year:	**$X,XXX**	**$X,XXX**

Allocations from United Way of $XXX and $XXX (designated for general operating purposes for the first three months of 2021 and 2020, respectively) have been recorded in the consolidated financial statements since the amounts were pledged in 2021 and 2020, respectively. The Council has been notified of an additional allocation from United Way in 2022 of approximately $XXX. The revenue from the additional allocation will be recorded when a firm commitment is received.

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 and 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- Case Study 14

A charitable organization holds a polo match each year as its major fundraiser. For the year ended June 30, 2013, the revenue in connection with the special event was $25,000. Approximately $17,500 of the revenue was contributions from sponsors and attendees. The remaining $7,500 was related to donor benefits such as food provided, cost of renting the polo field, cost of referees and parking. The $7,500 represents a fair value for the event itself. The cost of the direct donor benefits was $6,500. The $1,000 difference represents the approximate gross profit that would have been made on the event if held by another party.

During 2013, the charity incurred general and administrative costs of $52,000 which includes $1,500 in connection with the event, as well as $10,000 in fund-raising costs, $750 of which were in connection with the event. Contributions **not related** to the event were $250,000. Program expenses **unrelated** to the event were $120,000.

Special Events- Case Study 14

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

Special Events- Case Study 14

2. Special event revenue (gross) can be presented in the revenue section and the costs of direct benefits to donors in the same section as all other expenses

Contributions and Net Revenue from Special Event:	
Contributions	$250,000
Special event revenue	25,000
Total Revenue	275,000
Expenses:	
Program	120,000
Cost of Direct Donor Benefits	6,500
Management and General	52,000
Fund-Raising	10,000
Total Expenses	188,500
Increase in net assets without donor restrictions	$ 86,500

Special Events- Case Study 14

3. The contribution and exchange portion of the gross revenues are presented separately, with the cost of direct donor benefits deducted from the exchange portion

Contributions and Net Revenue from Special Event:		
Contributions		$267,500
Polo match sales	$7,500	
Less: Costs of direct benefits to donors	6,500	1,000
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

Disclosure- Special Event Policy Note

- Special fundraising event revenue: The Council conducts special events in which a portion of the gross proceeds paid by the participant represents payment for the direct cost of the benefits received by the participant at the event— the exchange component, and a portion represents a contribution to the Council. Unless a verifiable objective means exists to demonstrate otherwise, the fair value of meals and entertainment provided at special events is measured at the actual cost to the Council. The contribution component is the excess of the gross proceeds over the fair value of the direct donor benefit. The direct costs of the special events, which ultimately benefit the donor rather than the Council, are recorded as costs of direct donor benefits in the (consolidated) statement of activities and changes in net assets. The performance obligation is delivery of the event, which is usually accompanied by a presentation. The event fee is set by the Council. Professional literature requires allocation of the transaction price to the performance obligation(s). Accordingly, the Council separately presents in its [(consolidated) statements of activities and changes in net assets or notes to financial statements] the exchange and contribution components of the gross proceeds from special events. Special event fees collected by the Council in advance of its delivery are initially recognized as liabilities (deferred revenue) and recognized as special event revenue after delivery of the event. For special event fees received before year-end for an event to occur after year-end, the Council treats situations where the inherent contribution is conditioned on the event taking place and is therefore treated as a refundable advance along with the exchange component. There were no such conditions at December 31, 2021 and 2020.

Special Event Revenue- Footnote

NOTE 12—SPECIAL EVENT REVENUE (if this presentation is chosen)

Gross receipts from special fundraising events recorded by the Council consist of exchange transaction revenue and contribution revenue. Following is the separate presentation of the components of this revenue.

	2021	**2020**
Contributions	$X,XXX	$X,XXX
Special event revenue (exchange portion)	X,XXX	X,XXX
Special fundraising events - gross	**$X,XXX**	**$X,XXX**

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

Use of Long-lived Assets -Case Study 15

A social service agency (SSA) received the use of space from a business entity. The undiscounted value for the annual rental is $69,000 which is computed at $20,000 Y1, $23,000 Y2 and $26,000 Y3. This is because the location is growing in popularity and rents are increasing. Consideration paid each year is $5,000 each year so there is a lease component. The remainder is considered an unconditional promise to give which has been assessed as fully collectible. The space is usable in future periods so the contribution is donor restricted.

Management evaluated the lease and determined it should be classified as a **financing lease**. They do not know the rate implicit in the lease, so SSA used its incremental borrowing rate of 5% to discount.

Use of Long-lived Assets -Case Study 15 (con't)

Below Market Financing Lease & Contribution

Calculating the ROU asset and lease liability	
Value of Lease	
Fair value of rental - 3 X $5,000	15,000
Discount at 5%	(1,380)
Discounted value of rental	13,620
Value of contribution	
Total fair value of arrangement	69,000
Less fair value rents to be paid	(15,000)
Amount attributable to contribution	54,000
Discount on contribution receivable	(5,250)
Discounted value of contribution	48,750

Contribution Receivable	Year 1	Year 2	Year 3
Contribution rec. beginning of year	$ 54,000	$ 36,190	$ 20,000
Beginning of year discount	(5,250)	NA	NA
Amortization of discount (5%)	2,440	1,810	1,000
Fair value of donated lease rental	(15,000)	(18,000)	(21,000)
Contribution Rec.-End of Year	$ 36,190	$ 20,000	$ -

Use of Long-lived Assets -Case Study 15 (con't)

Below Market Financing Lease & Contribution

Journal Entries

Contribution Portion						
Contribution receivable	48,750					
Contribution revenue with donor restrictions		48,750				
To record the initial contribution						
Annual Journal Entry 1	**Year 1**		**Year 2**		**Year 3**	
Lease expense	15,000		18,000		21,000	
Contributions receivable		20,000		18,000		21,000
To record the expense related to donated space						
Annual Journal Entry 2						
Net assets released from restriction - with donor restriction	15,000		18,000		21,000	
Net assets released from restriction - without donor restriction		15,000		18,000		21,000
To release amounts from restriction						
Annual Journal Entry 3						
Contribution receivable	2,440		1,810		1,000	
Amortization - contribution with donor restriction		2,440		1,810		1,000
To amortize the discount						

Use of Long-lived Assets -Case Study 15 (con't)

Below Market Financing Lease & Contribution

	Year 1	Year 2	Year 3
Accounting for the Lease Component			
Lease liability			
Lease liability beginning of year)	13,620	9,290	4,750
Add amortization (lease expense)	670	460	250
Less lease payment	(5,000)	(5,000)	(5,000)
Lease liability end of year)	9,290	4,750	-
Right of Use Asset			
ROU asset, beginning of year	13,620	9,080	4,540
Less amortization (lease expense)	(4,540)	(4,540)	(4,540)
ROU asset,end of year	9,080	4,540	-

Use of Long-lived Assets -Case Study 15 (con't)

Below Market Financing Lease & Contribution

Journal Entries

Initial entry to record the Lease Portion

Lease Portion	Dr	Cr
ROU Asset, net of discount	13,620	
Lease liability		13,620
To record the initial lease entry		

	Year 1		Year 2		Year 3	
Annual Journal Entry 1						
Lease expense	670		460		250	
Lease liability	4,330		4,540		4,750	
Cash		5,000		5,000		5,000
To record the payment of the rent						
Annual Journal Entry 2						
Amortization of ROU Asset	4,540		4,540		4,540	
ROU Asset		4,540		4,540		4,540
To record amortization of the ROU asset						

Use of Long-lived Assets -Case Study 15 (con't)

The next chart illustrates the rent (lease) expense. In an operating lease under ASC 842 the lease is a consistent amount. Although it represents the same components of interest and amortization of the ROU asset, the distinction is that the ROU asset is adjusted so that the lease expense is ratable over the years. In the finance lease, the ROU asset is amortized at a consistent rate and the lease expense is not consistent. The contribution portion is not illustrated as it is the same as with the finance lease.

Below Market Operating Lease (contribution not shown)

Operating Lease	Year 1	Year 2	Year 3
Lease liability, beginning	13,620	9,290	4,750
Amortization treated as lease expense	670	460	250
Minus lease payment	(5,000)	(5,000)	(5,000)
	9,290	4,750	-
Right of Use Asset			
ROU asset, beginning	13,620	9,290	4,750
Less amortization - lease expense	(4,330)	(4,540)	(4,750)
	9,290	4,750	-
Lease expense is one consistent amount	5,000	5,000	5,000

Use of Long-lived Assets -Case Study 15 (con't)

Below Market Operating Lease (contribution not shown)

Journal entries for operating lease - 3 years						
	Year 1		Year 2		Year 3	
Portion that represents the lease						
Lease expense	5,000		5,000		5,000	
Lease liability	4,330		4,540		4,750	
Cash		5,000		5,000		5,000
ROU asset		4,330		4,540		4,750

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.

Below Market Loans- Case Study 16

A NFP received an interest free loan on January 1, 20X2 in the amount of $200,000. The market rate of interest was 6%. There were no restrictions other than timing since the loan could be used to pay operating expenses. The accounting manager made the following journal entries.

Year 1			
Cash		200,000	
Loan Payable			167,924
Contribution Revenue			32,076
To record the interest free loan - interest imputed at 6%, term of 3 years			
Interest Expense		10,075	
Loan Payable			10,075
To record the accretion of the loan using the effective interest method			
Net assets with donor restriction		10,075	
Net assets without donor restriction			10,075

This pattern would continue with the following amortization			
		Loan payable	167,924
		Year 1 accretion	10,075
		Year 2 accretion	10,680
		Year 3 accretion	11,321
			200,000
Year 3 Loan Repayment			
Loan Payable		200,000	
Cash			200,000
To record the repayment of the loan.			

If, at the end, the loan was forgiven this would be additional contribution revenue.

Contributed Collection Items

- Collection items are works of art, historical treasures or other assets that meet these criteria:
  - Held for public exhibition, education or research not for financial gain
  - Protected, kept unencumbered, cared for and preserved
  - Subject to organizational policy that requires proceeds of items that are sold to be for the acquisition of new collection items, the direct care of existing collection items or both
- Collection items may be recorded on the books and records or not depending on the entity's policy

Contributed Collection Items

An organization may capitalize collections but is not required to:

- If organization decides to capitalize collections, then it will capitalize items received as assets, regardless of whether they were acquired by contribution or in exchange transactions
- If an organization has a policy of not capitalizing collections, then contributions would not be recognized

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.

Split-Interest Agreements

Agreement	Initial Recording of Fair Value of the Contribution	Subsequent Re-measurement
Remainder interests – held by the not-for-profit in trust with the not-for-profit as trustee or as general assets and liabilities of the not-for-profit	Estimated based on the fair value of the assets transferred by the donor less the present value of the payments to be made to the other beneficiaries. See discussion below relative to income and market approaches for split-interest agreements with variable and fixed payment streams.	The discount is amortized and changes are made if there are changes in any of the assumptions such as the life expectancy of the donor.
Lead Trusts – if held in trust by the not-for-profit	Fair value of the contribution can be estimated directly based on the present value of the future distributions to be received by the not-for-profit as a beneficiary. The future payments to be made to other beneficiaries are made by the not-for-profit only after the not-for-profit receives its benefits.	The discount is amortized and changes are made if there are changes in any of the assumptions such as the life expectancy of the donor.
Trusts where there is an outside trustee	Initial recording is as noted above but is made by the trustee. The not-for-profit will have a beneficial interest that is reported to it by the trustee. This may be 100% of the trust or may be less.	The trust is marked to fair value with an adjustment for appreciation/ depreciation so that the trust is stated at fair value. The adjustment is made to temporarily restricted net assets.

Split-Interest Agreements

- Three types of remainder interests- charitable remainder trust, charitable gift annuity and pooled income funds.
- **Charitable remainder trust-** the donor establishes and funds a trust with specified payments to be made to a designated beneficiary over the term of the trust.
  - In some cases, these periodic payments are for a specific dollar amount, called an annuity trust. Another form of charitable remainder trust is the unitrust or CRUT.
  - Some charitable remainder unitrusts limit the annual payout to the lesser of the stated percentage or the actual income earned. Obligations to the beneficiaries are limited to the trust's assets.
- **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.

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, Case Study 17

A NFP museum's advancement director began soliciting donations in the form of a charitable remainder trust with the NFP being the trustee. At the death of the donor the remaining assets would be placed in the organization's endowment funds. The mechanism provides the donor with a way to give and still have the cash flow that they were used to having in the form of the investment income. The controller performed research on how to record this agreement. In the first split interest agreement they received the donor gave $500,000. Under the terms of the agreement, the NFP pays the donor 5% of the value of the trust for the remainder of her life. She is 58 right now. Since the NFP was the trustee, he calculated the liability to the donor.

Assets contributed to the trust	$500,000
Age of donor – female	58
Payout over time	5% of the net assets of the trust until the donor's death
Expected return on assets	Assume 7% over time

Split-Interest Agreements, Case Study 17 (con’t)

The controller used the income approach for valuation since there were observable inputs. A split interest agreement is like a fixed rate or variable annuity. The controller set up a unitrust so that the assets from the trust would never be totally drained. ASC 820 states that the fair value measure of a liability should capture the following elements from the perspective of a market participant as of the measurement date.

- Estimate of cash flows being measured
- Expectations about variations in the amount of cash flows (uncertainty)
- Risk premium for bearing the uncertainty
- Nonperformance risk including the entity’s credit risk
- Other factors specific to the situation

Split-Interest Agreements, Case Study 17 (con’t)

- Higher risk means higher discount rate
- Split interest gift to be funded from at trust, it is the trust’s obligation to make payment

The controller used tables from the Society of Actuaries to estimate the life expectancy. The trust set up resulted in the use of a fairly low discount rate. The payout is based on the value of the trust so it the probability is remote that a default would occur. Therefore, using the expected rate of return on the asset would be appropriate.

Split-Interest Agreements, Case Study 17 (con't)

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, Case Study 17 (con't)

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, Case Study 17 (con't)

Journal entry to record the trust			
Cash (to the trust for investment)		500,000	
Liability to the donor			359,313
Contribution to the museum - donor restricted			140,687
To record the contribution at FV at the date of donation and the liability to the donor			

- For the remainder of the donor's life the trust will:
  1. make the required payout
  2. increase the value of the trust by the income
  3. Amortize the discount and adjust the liability to reflect changes in actuarial assumptions

Split-Interest Agreements, Case Study 17 (con't)

- Ongoing Journal entries until the death of the donor
  - (1) DR liability under unitrust agreement XX
    - CR Assets held in remainder Trust XX
  - (2) DR Assets in remainder Trust XX
    - CR Liability under unitrust agreement XX
  - (3) DR Liability under trust agreement
    - CR Change in value of Split-interest agreement- donor restricted
- At the termination of the trust and closing the trust
  - DR Liability under unitrust agreement XX
    - CR Change in Value of split interest agreements- donor restricted XX
  - DR Endowment assets XX
    - CR Assets held in remainder trust XX

Split-Interest Agreements

- Derecognition of liability
  - Some NFP prefer not to have a liability on their books and would like to purchase an annuity to cover the payments to the donor
  - NFP may do this, but it cannot remove the liability from its books.
  - ASC 405 states that a debtor can derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:
    - The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds.
    - The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

Split-Interest Agreements

- Trust held by a third party in perpetuity
- 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.

Split-Interest Agreements

- Appropriate proxy for using income valuation technique because the assumption is based on the stream of payments into perpetuity which equals the value of the trust.
- Trustee may provide summary information or detailed information.
- AICPA whitepaper states that a beneficial interest in a perpetual trust would be disclosed as a Level 3 investment.

Case Study 17

An auditor of a NFP selected a cash receipt from a Trust Company for testing. He asked the client what the payment was for. The clerk noted that no correspondence came with the payment but that the NFP received them every quarter in the same amount. The NFP asked the client to follow up on the payment since it could represent a beneficial interest in a perpetual trust that should have been recorded.

Agency Transactions

- Agency transactions are a type of exchange transaction where the NFP acts as an agent, trustee or intermediary for another party who may be a donor or donee.
  - Donor
  - Resource provider
  - Recipient
  - Beneficiary
  - Variance power

Agency Transactions

- **Agency transaction-** entity acts for and on behalf of another. Recipient acts as an agent:
  - Receives assets from the donor and agrees to use them on behalf of or transfer the assets, the return on investment of the assets or both to a specified beneficiary
  - Agrees to solicit assets from potential donors for the beneficiary's use and distribute them to the beneficiary
  - If beneficiary can compel the recipient to make distributions on its behalf
- **Intermediary transactions**- this is where the recipient acts as a facilitator for the transfer of assets but is not an agent or trustee.

Agency Transactions

- If there is an unaffiliated specified beneficiary, then the recipient organization is considered an agent and records and asset and a liability to the donor.
- Fees paid from that would be considered revenue to the recipient.
- When there is variance power the recipient will record revenue.

Case Study 18

A fundraising organization solicits donations from corporations and individual donors. Although the advancement personnel try to get the donors to donate to the fundraising organization so that they can make grants to other NFPs, many donors prefer to designate a beneficiary.

Agency Transactions

- Main Applications as it Relates to Agency Transactions
  1. Organizations receive assets from donors where a beneficiary is designated by that donor
  2. Organizations unrelated to the not-for-profit organization receive assets from not-for-profit organizations to hold and manage
  3. A recipient and a specified beneficiary may be financially interrelated
- Unrelated Fundraising Organization with Variance Power
- Community Foundation

Agency Transactions

- Financially Interrelated Foundations- Two conditions must be met:
  1. One must have the ability to influence the operating and financial decisions of the other
     - Organizations are affiliates
     - One has considerable representation on the board of the other
     - Charter or bylaws of one limit its activities to those that benefit the other
     - An agreement between the two allows one to participate in policymaking processes for the other
  2. One organization has an ongoing economic interest in the net assets of the other

Agency Transactions

- Financially Interrelated Foundations- transaction may be an equity transaction. Following must be present:
  - The resource provider specifies itself or an affiliate as the beneficiary
  - The resource provider and the recipient are financially interrelated
  - Neither the resource provider or affiliate expects payment of the transferred assets although they may expect the investment return to be paid

Agency Transactions- Case Study 18

The board of an independent school (K-6) wanted to expand to encompass grades 7-12. To do this effectively the strategic plan included a commitment to add those grades over then next 5 years. The school held at least one fundraiser a year with the proceeds restricted to the growth of the organization. Over the last 5 years the school had $2,000,000 in net assets that were held in an investment account at a bank. The net assets were restricted by the donors for expansion of the school and could be used for building, equipment, or anything related to expanding the school through grade 12.

The board decided that it would be prudent to create a foundation to hold the $2,000,000 in assets and to use that foundation to raise money for the expansion. The board of newly established Foundation has the Head of School on it, but no other overlapping board members..

The entities are **financially interrelated** because the School has the ability to influence the operating and financial decisions of the Foundation, the charter and bylaws limit the activities of the Foundation to those that benefit the school **and** the school has an ongoing economic interest in the net assets of the Foundation. In this case, the school's interest either increases or decreases as a result of the fund raising and operating activities of the Foundation.

Agency Transactions- Case Study 18 (con't)

The Controller transferred the $2,000,000 in investments to the newly created Foundation. The School's attorneys drafted an agreement that would allow the school to **request distributions from both the original investments and the return on those investments** subject to the approval by the governing board of the Foundation. The agreement states that any reasonable requests will not be denied. The agreement also covers any other assets transferred to Foundation by the School.

Agency Transactions- Case Study 18 (con't)

Resource Provider: School
Recipient: Foundation
Specified Beneficiary: School

Consideration	Answer
Was there a transfer of assets?	**YES**
Does the resource provider retain the right to redirect the assets to another beneficiary?	**NO**
Is the transfer accompanied by a conditional promise to give or is it revocable or repayable?	**NO**
Does the resource provider control the recipient organization and specify an unaffiliated beneficiary?	**NO**
Does the resource provider specify itself or its affiliate as the beneficiary?	**YES**
Does the transfer meet all of the criteria for an equity transaction?	**NO**

Agency Transactions- Case Study 18 (con't)

Resource Provider: School
Recipient: Foundation
Specified Beneficiary: School

Analysis: The transfer does not meet all of the criteria for an equity transaction because although the resource provider specified itself as the beneficiary and the resource provider and the recipient are financially interrelated, the resource provider expects payment of the transferred assets.

Journal Entry:

Resource Provider	Recipient	Specified Beneficiary
DR Asset	DR Investments	Beneficiary is the resource provider so no additional entries are necessary
CR Investments	CR Liability to resource provider	

Agency Transactions- Case Study 18 (con't)

The School wanted to raise $4,000,000 to fund the building, furniture and equipment The Foundation sent out solicitation letters that stated that all of the money would be used to fund the expansion activities of the School. The donations were to be sent to the Foundation and if they were accidentally sent to the School they were promptly forwarded to the Foundation.

Consideration	Answer
Was there a transfer of assets?	**YES**
Does the resource provider retain the right to redirect the assets to another beneficiary?	**NO**
Is the transfer accompanied by a conditional promise to give or is it revocable or repayable?	**NO**
Does the resource provider control the recipient organization and specify an unaffiliated beneficiary?	**NO**
Does the resource provider specify itself or its affiliate as the beneficiary?	**NO**
Did the donor grant variance power to the recipient organization?	**NO**
Are the recipient and the specified beneficiary financially interrelated organizations?	**YES**

Agency Transactions- Case Study 18 (con't)

The School is the specified beneficiary. It has an interest in the net assets of the Foundation because of the financial interrelatedness. The Foundation has revenue because this is their activity, and the donors gave to them for the specified beneficiary (school). The resource provider is the donor, and their accounting doesn't have an impact on the School or the Foundation.

Recipient	Specified Beneficiary
DR Cash	DR Interest in the net assets of the Foundation
CR Contribution revenue	CR Change in interest in the net assets of the Foundation (this could be recorded at the time or periodically)

The School classifies the transaction as with or without donor restriction based on its ability to influence the distributions of the funding. If the Foundation has little discretion over the expenditure the classification is without donor restriction once the expenditure is made.

Agency Transactions

- **Transactions with Community Foundation**
- NFP that accept financial assets from a donor and agree to use the assets on behalf of a specified **unaffiliated beneficiary** or transfer the assets themselves or the income from those assets to a specified unaffiliated beneficiary should recognize the fair value of the assets, as well as the liability to the beneficiary.
- CF agreements typically state that the Community Foundation will never return the assets themselves to NFP but will give the NFP the return on the assets. Even though the agreement goes on to say that the Community Foundation has the right to redirect the assets, the FASB determined that this was a reciprocal transaction.
- NFP is transferring the assets in exchange for future distributions.
- At the time of the transfer, the Community Foundation is stating that it has the ability to fulfill the obligation and that the transfer of the investment return to the not-for-profit organization is consistent with its mission.

Agency Transactions

Transactions with Community Foundation- NFP establishes a Fund

★ Resource Provider- NFP establishing a Fund

Beneficial interest in assets held by Community Foundation	XX	
Investments		XX

★ The recipient (Community Foundation) will record the following:

Investments	XX	
Liability to resource provider		XX

In subsequent periods, the Resource Provider will increase cash when there are transfers to the organization (return). It will adjust the beneficial interest for changes in asset valuation. The recipient will account for the change in the value of the investments and investment income. It will also decrease the investments for any amounts transferred to the resource provider.

Agency Transactions

- **Transactions with Community Foundation**
- If the CF is soliciting donations for a NFP and the agreement specifies variance power, then the CF has revenue.
- Pledge materials specify that gifts sent to CF will be used to establish a fund for the not-for-profit and that some or all of the investment return is intended to be used for the not-for-profit
- When the CF makes a distribution to the NFP then the NFP will record the donation.

Example Footnote- Beneficial Interest in Assets Held by Others

In 19XX the Organization transferred $2,000,000 from its investment portfolio to the Community Foundation to establish an endowment fund. Under the terms of the agreement, in the first quarter of each year, the Organization receives a distribution equal to the investment return generated by the transferred assets during the prior year. The Organization can with draw any or all of the original amount transferred, provided that a majority of the governing board of the Organization and the Community Foundation approve the withdrawal. At the time of the transfer, the Organization granted variance power to the Community Foundation. This power gives the Community Foundation the right to distribute the investment income to another not-for-profit entity of its choice if the Organization ceases to exist or if the governing board of the Community Foundation votes that support of the Organization is no longer necessary or is inconsistent with the needs of the community. At June 30, 20X1 the endowment fund has a value of $3,248,445, which is reported in the statement of financial position as its beneficial interest in assets held by others.

Reminders

- ❑ **Post event evaluation:** Please complete the course evaluation that will be pushed out to you as a pop up link on your screen. We welcome your feedback!

KAPLAN