



Preparing For The New Revenue Recognition Standard

BY THOMAS H. MARTIN

The adoption date of the new standard Revenue from Contracts with Customers (Accounting Standards Codification (ASC) Topic 606) issued by the Financial Accounting Standards Board (FASB) is imminent. Most nonprofit organizations (nonpublic entities) should apply ASC 606 for annual reporting periods beginning after Dec. 15, 2018.

Nonprofits have the option of early adoption for fiscal years beginning after Dec. 15, 2016.

Although there seems to be plenty of time to prepare for adopting ASC 606, it is advisable to start evaluating the impact on your organization and making any changes needed to apply the standard as soon as possible. ASC 606 represents a change from rules-based accounting to a principal-based focus. In some situations, such as estimates related to variable considerations (discounts, incentives, credits and price concessions), you will be required to make more estimates and use more judgment than with the current guidance.

The new standard will generally not be applicable if your organization is funded solely by contributions. Contributions are

not specifically excluded but do not fall within the definition of revenue covered by ASC 606. Investment and rental income, likewise, do not fall within the definition of revenue covered by ASC 606.

All revenue recognition policies for exchange transactions will be affected by ASC 606. Therefore, the following revenue sources may be impacted: memberships,

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products and services, sponsorships, tuition, advertising, royalties, conferences and seminars, as well as federal and state grants and contracts.

The first step you should take to adopt ASC 606 is to review all current revenue streams and evaluate if there are any differences between current practices and the new standard. For revenue streams in which the new standard applies, you will have to determine what additional information has

to be captured to properly recognize revenue and comply with the required disclosures in the new standard.

It is important that your accounting and other departments are aware of what new information is needed so that the systems, processes and controls are in place. You might have to update your financial and accounting software to capture this new information, as well as your accounting policies and internal controls.

You will also have to analyze all of your contracts to determine if they include an exchange transaction, a contribution or both. Since ASC 606 only applies to exchange transactions, this revenue will have to be identified and separated from the contribution component. You might consider changing standard contracts so it is easier to comply with the new standard.

ASC 606 requires organizations to take a five-step approach to determine when revenue should be recognized:

- Identify the contract with a customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price among the

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performance obligations in the contract; and,

- Recognize revenue when the organization satisfies a performance obligation.

Revenue should not be recognized until each performance obligation is satisfied. This could require allocating the transaction price among multiple performance obligations.

For example, an annual membership fee may provide the member with benefits such as educational opportunities, advocacy efforts, industry information, and a quarterly newsletter. The performance obligations are the provision of membership services for one year and subscription services for the quarterly newsletter.

The membership fee must be allocated between the two based on the fair value of each service. In this example, the membership fee portion would be recognized over the 12-month period that the services are provided and the newsletter subscription would be recognized each quarter as the newsletter is issued.

Another typical source of revenue for non-

profits are grants from government agencies. You will have to decide if the contract is an exchange transaction or a contribution. The new definitions related to revenue recognition might require that some or all of your grants be reclassified. Grants that previously fit the criteria of exchange transactions may now better align with the definition of a conditional contribution than that of a contract with a customer.

The determination of revenue for grants considered to fall under the new standard will require much more analysis and judgment by management, which might result in significant changes in the timing of revenue recognition. There is uncertainty about whether grants that are classified as exchange transactions fall under the new standard.

Some nonprofit managers consider their grantors to be partners or collaborators in delivering services and believe that they do not fall under FASB's definition of a customer. Additional guidance is therefore needed to make the proper accounting for grants more clear.

The full impact of the new revenue recognition standard on your organization could be difficult to determine at this time. Even so, you should prepare now to adopt ASC 606 so that you know what you will have to do and the potential effect on your financial statements and unrelated business taxable income.

You also need to consider if debt covenants have to be revised because of the impact on revenue, key financial ratios and other requirements. Communication between management, the audit committee, and your auditor is important to ensure that everyone understands how ASC 606 will affect your organization and agrees with how you will comply with this standard. **E**

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