NEW REVENUE RECOGNITION GUIDANCE – WHAT NONPROFITS NEED TO KNOW!

March 8, 2018

With you today

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Revenue From Contracts with a Customer (ASU 2014-09)

Revenue Recognition (Topic 606)

- Objective: To develop a single, principle-based revenue standard for U.S. GAAP and IFRS

- The revenue standard aims to improve accounting for contracts with customers by:
  - Providing a robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

Substantially converged with IFRS on major provisions

Scope

- All contracts with customers, <u>except</u>
  - Lease contracts
  - Insurance contracts
  - Financial instruments
  - Guarantees
  - Non-monetary exchanges in the same line of business to facilitate sales to customers

- Contracts not with customers are excluded:
  - Contributions
  - Collaborative arrangements

Final U.S. GAAP Model – Recognition

- Core Principle:

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

- Steps to apply the core principle:

1. Identify the contracts with the customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when (or as) a performance obligation is satisfied

Final U.S. GAAP Model – Disclosure

Disaggregation of revenue	Qualitative and quantitative disaggregation of revenue into categories that depict how revenue and cash flows are affected by economic factors
Information about contract balances	Opening and closing balances Amount of revenue recognized from contract liabilities * Explanation of significant changes in contract balances *
Remaining performance obligations	Transaction price allocated to remaining performance obligations * Quantitative or qualitative explanation of when amounts will be recognized as revenue *
Interim requirements	Quantitative disclosures *

* for public entities/ conduit debt obligors only

Revenue Recognition – Implementation Issues

- Transition Resource Group (TRG) has discussed 108 implementation issues
  - All have been closed and no more meetings currently planned
  - Technical Inquiry Service available
- Follow-up ASUs issued:
  - ASU 2015-14: deferred effective date by one year
  - ASU 2016-08: principal vs. agent considerations
  - ASU 2016-10: identifying performance obligations; licenses of intellectual property
  - ASU 2016-12: narrow-scope improvements and practical expedients
  - ASU 2016-20: technical corrections and improvements
  - ASU 2017-05: asset derecognition and partial sales of nonfinancial assets
- Related FASB project: Grants and Contracts to NFPs (discussed in the next section)
- AICPA nearing completion of their work on applying Rev. Rec. guidance to various industry groups

Revenue Recognition – Transition

Transition method		PY2 (2016)	PY1 (2017)		CY (2018)	CY Footnotes
Retrospective (with optional practical expedients)	Cumulative catch-up	Contracts under new standard				
Cumulative effect at date of application		Contracts under legacy standard		Cumulative catch-up	Existing and new contracts under new standard	Existing and new contracts under legacy standard for CY (2018)

Transition dates for non-public entities are extended one year later than the dates above

BDO

Revenue Recognition – Transition Practical Expedients

- No restatement required for contracts that begin and are completed within the same annual reporting period
- Completed contracts that have variable consideration:
  - Use transaction price at completion
  - No estimation required
- No restatement required for contract modifications that occur before the beginning of the earliest period presented
- Modified retrospective approach may be applied to all contracts or completed contracts only

Significant judgment needed

BDO

Definition of Conduit Debt

Definition of Conduit Debt (FAS 126-1)

- A conduit debt security is an offering by a governmental entity that is not for its own use but for the use of a private party
- The governmental entity that issues conduit debt securities does not have any subsequent liability or continuing involvement
- In the initial security offering, the governmental entity is listed as the issuer, and the entity that receives the proceeds from the sale of the conduit debt security is listed as the obligor.
- The conduit bond obligor is required to make or fund all interest and principal payments as they become due, and any future financial reporting requirements also are the responsibility of that conduit bond obligor.

<u>An organization that has debt with a governmental entity (municipality, state, government etc.) and is obligated to make all principal and interest payments is considered to be conduit debt obligor.</u>

BDO

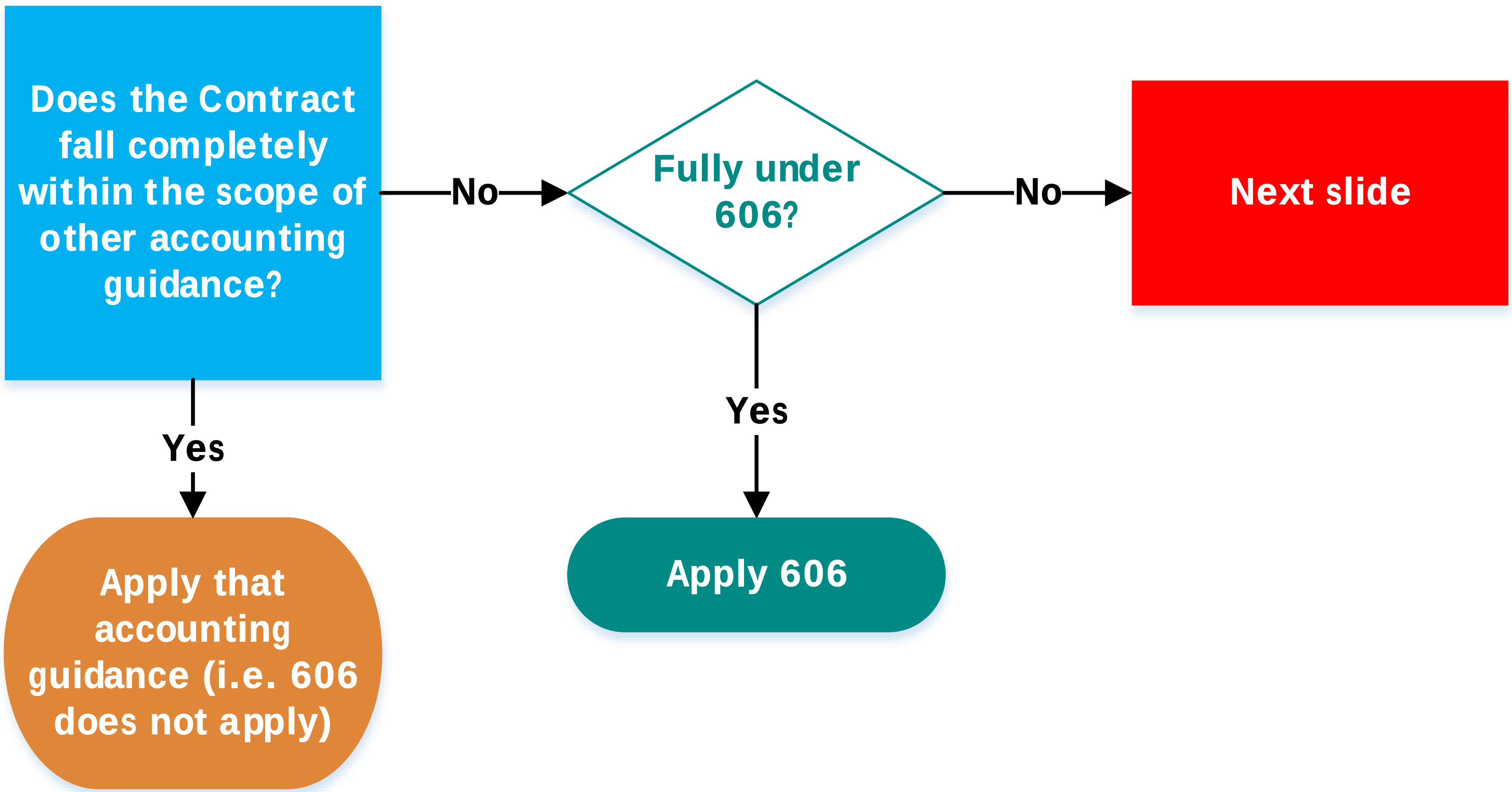
Effective Date of Topic 606 for Conduit Debt Obligors

Effective Date for Topic 606	
Annual periods beginning after December 15, 2017, including interim periods: • Public Business Entities • NFP that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on exchange or an over-the counter market	Annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019: • All other entities

Revenue from Contracts with Customers
Scoping

Revenue from Contracts with Customers

Scoping – Does the Revenue Stream Fall Within Scope of 606



Revenue from Contracts with Customers

Scoping – Does the Revenue Stream Fall Within Scope of 606

The parties to the contract must approve it and be committed to perform their respective obligations.

Yes

Does the other accounting standard have guidance related to initial measurement that applies?

Yes

Use the other accounting guidance to separate the contract and initially measure the non-606 element of the contract.

Exclude the amount of the contract that is under other accounting guidance and use that as the transaction price for part of the contract under 606

No

Apply the guidance in 606 to separate and initially measure the part of the contract that falls under other accounting guidance and the part of the contract that falls under 606.

Scoping

"Step 0" – Contribution vs exchange transaction

Contribution –

- An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary non-reciprocal transfer by another entity acting other than as an owner.
- Because a contribution is both <u>voluntary</u> and <u>non-reciprocal</u>, it is scoped out of Topic 606 by definition.

Exchange Transaction –

- A reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations.
- Because an exchange transaction is <u>reciprocal transaction in which two parties exchange something of commensurate value</u>, it is scoped in the Topic 606 by definition.

Scoping

"Step 0" – Contribution vs exchange transaction

Indicator	Contribution	Exchange Transaction
What is the recipient nonprofit's intent in soliciting the asset or service?	Recipient nonprofit asserts that it is soliciting the asset / service as a contribution	Recipient nonprofit asserts that it is seeking resources in exchange for specified benefits
What is the resource provider's expressed intent about the purpose of the asset to be provided to the recipient nonprofit?	Resource provider asserts that it is making a donation to support the nonprofit's programs.	Resource provider asserts that it is transferring resources in exchange for specified benefits.
What is the method of delivery?	The time or place of delivery of the asset to be provided by the recipient nonprofit to third-party recipients is at the discretion of the nonprofit.	The method of delivery of the asset / service to be provided by the recipient nonprofit to third-party recipients is specified by the resource provider
Are there penalties asserted if the nonprofit fails to make timely delivery of assets / services?	Penalties are limited to the delivery of assets already produced and the return of the unspent amount (the nonprofit is not penalized for nonperformance)	Provisions for economic penalties exist beyond the amount of payment (the nonprofit is penalized for nonperformance)
Who receives the assets that are provided by the recipient nonprofit?	Assets are to be delivered to individuals or organizations other than the resource provider.	Assets are to be delivered to the resource provider or to individuals or organizations closely connect to the resource provider

Source: FASB ASC 958-605-55-8

Scoping

"Step 0" – Contribution vs exchange transaction

Nonprofit A offers various sponsorship levels for their annual educational conference.

- Company C has selected to be a Gold Sponsor for $50,000. The terms of the "Gold" sponsorship agreement are as follows:
  - Night one dinner reception sponsor with Company C name displayed as backdrop on the main stage
  - Company C logo on the conference website
  - Visual stage recognition during general sessions
  - Booth space and free internet access (offered to non-sponsors at $1,000 per booth)
  - 5 conference passes (offered to attendees at $500 per pass)

Under "Step 0" – Do we have a contribution, an exchange transaction or both?

Scoping

“Step 0” – Contribution vs exchange transaction

Under “Step 0” – Do we have a contribution, an exchange transaction or both?

Elements of an Exchange Transaction	Elements of a Contribution
- Booth Space - Conference Passes	- Dinner Reception Sponsor - Logo on Website - Visual Stage Recognition

Scoping

“Step 0” – Contribution vs exchange transaction

Exposure Draft: Topic 958 – Not-for-Profit Entities

Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made

Key Provisions:

1) Assist entities in evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958, Not-for-Profit Entities, or as exchange (reciprocal) transactions subject to other guidance

2) Assist entities in distinguishing between conditional contributions and unconditional contributions

Scoping

"Step 0" – Contribution vs Exchange Transaction (Proposed)

Indicator	Contribution	Exchange
The resource provider receives no direct value in exchange for the assets transferred (i.e. no commensurate value)	X	
The value received by the resource provider is incidental to the potential public benefit from using the assets transferred (i.e. no commensurate value).	X	
The resource provider is executing under its mission or the positive sentiment from acting as a donor	X	
The expressed intent asserted by both the recipient and the resource provider is to exchange resources for goods and services that are of commensurate value		X
The recipient solicits assets from the resource provider without the intent of exchanging goods or services of commensurate value	X	

Scoping

"Step 0" – Contribution vs exchange transaction (Proposed)

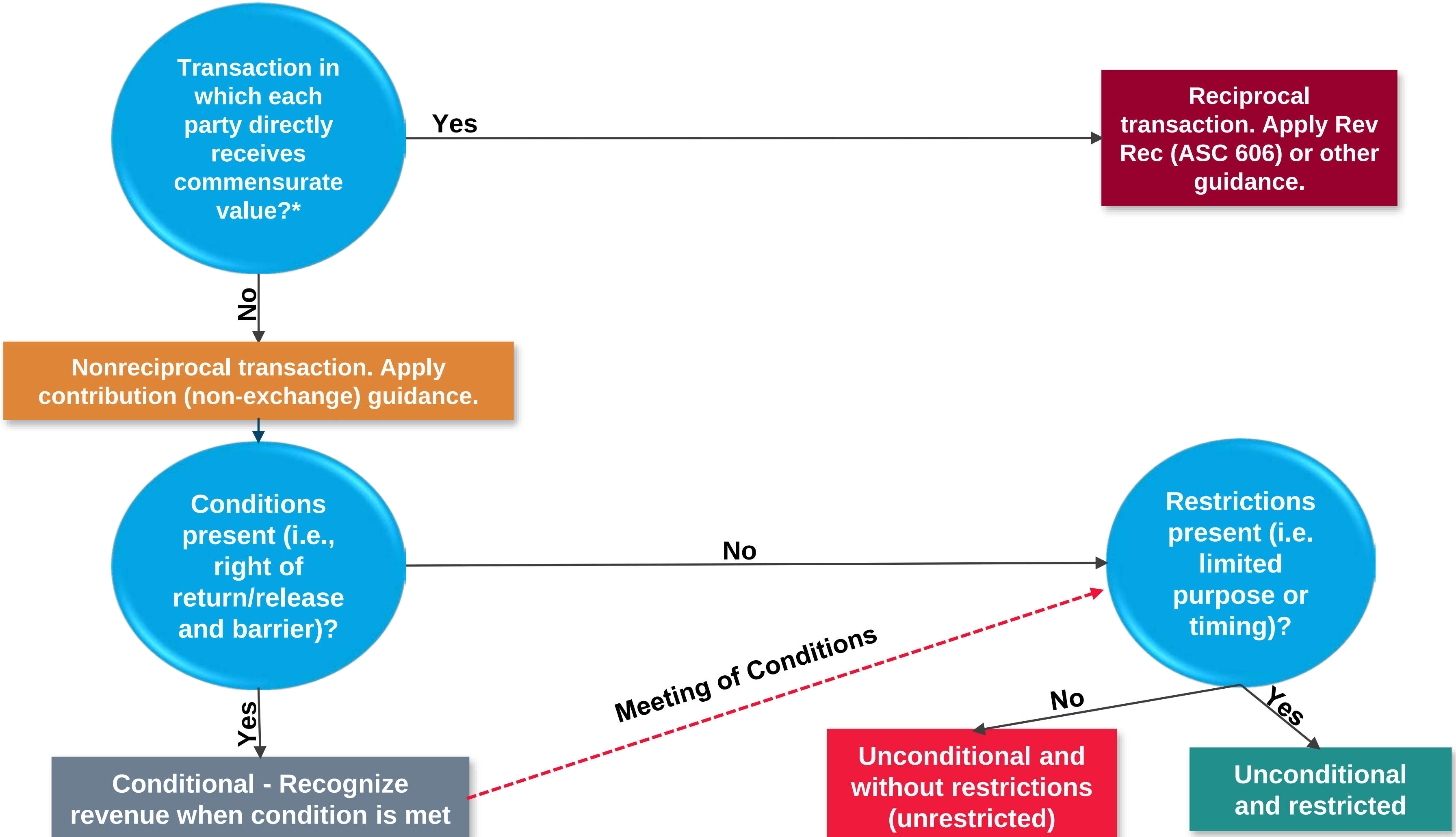
Indicator	Contribution	Exchange
The resource provider has full discretion in determining the amount of the transferred assets.	X	
The recipient and the resource provider agree on the amount of assets transferred in exchange for goods and services that are of commensurate value		X
Penalties assessed on the recipient for failure to comply with the terms of the agreement are limited to the delivery of the assets provided and the return of the unspent amount.	X	
Contractual provisions for economic forfeiture beyond the amount of assets transferred by the resource provider to penalize the recipient for nonperformance.		X

Proposed Accounting Guidance

Donor Imposed Conditions

- A donor imposed condition must have:
  - A barrier
  - A right of return to the promisor for assets transferred or a right of release of the promisor from its obligation to transfer assets.

NFP Revenue Recognition Decision Process (Proposed)



*Includes third-party payments on behalf of identified customers. These do not create new revenue.

Revenue from Contracts with Customers
Step 1

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – IDENTIFY THE CONTRACT

Points to note

- Contracts can be written, oral, or implied by the entity's business practices
- Contracts with customers must meet ALL the following criteria:

i) The parties to the contract must approve it and be committed to perform their respective obligations.

ii) Each party's rights regarding goods and services to be transferred can be identified.

iii) The payment terms for goods and services to be transferred can be identified.

(iv)The contract must have commercial substance.

(v) It is probable that the entity will collect the consideration to which it is entitled.

Note: Reassessment required in certain circumstances.

COLLECTABILITY CONSIDERATIONS

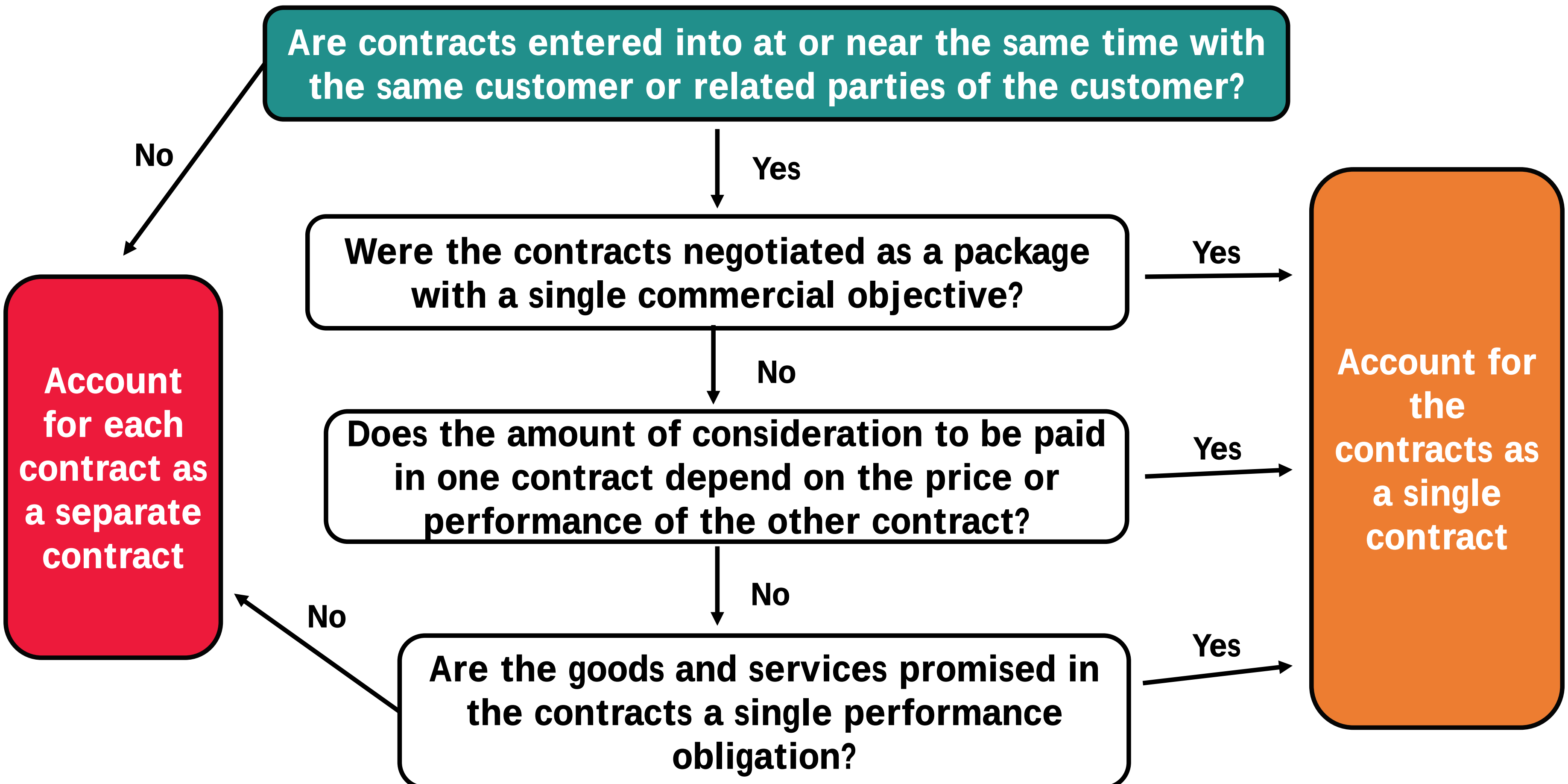
STEP #1

- Concept of collectability is slightly different between Topic 605 (old GAAP) and Topic 606
- Assessment is based on whether the customer has the ability and intention to pay the consideration to which the entity will be entitled in exchange for the goods or services that will be transferred to the customer.
- Assessment is not necessarily based on the customer's ability and intention to pay the entire amount of promised consideration for the entire duration of the contract.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – IDENTIFY THE CONTRACT

COMBINATION OF CONTRACTS



REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – IDENTIFY THE CONTRACT

Contract modifications

- Contract modifications are changes in the scope and/or price of the contract:
  - i.e. create new or amend existing enforceable rights and obligations.
- A contract modification must be approved, in writing, orally, or otherwise as implied by the entity's business practices
- **Depending on the circumstances may be accounted for as follows:**
  - **A separate contract**
  - **Termination - replace the old contract with the new contract**
  - **Continuation – treat modification as part of the original contact**

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – EXAMPLE

Membership Dues

- Membership application is signed by the member and ABC nonprofit on 1/1/2019
- The price of the membership is $500 per member per year which includes:
  - A $5 donation toward the scholarship fund for students who are pursuing a career in science (non-refundable)
  - The promise to the member to provide legislative advocacy services during the one-year term
  - The promise to provide access to the members-only section of the nonprofit's website
  - The promise to the member of a subscription to provide 4 quarterly scientific journals
- The scientific journals are sold in bookstores and online for $20 per journal

Do we have a contribution? Do we have an exchange transaction? Do we have both?

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – EXAMPLE

Membership Dues

- **Do we have a contribution? Do we have an exchange transaction? Do we have both?**

Elements of an Exchange Transaction	**Elements of a Contribution**
- Legislative Advocacy - Website Access - 4 Quarterly Journals	- $5 Scholarship Donation

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – EXAMPLE

Membership Benefits - Topic 606

The parties to the contract must approve it and be committed to perform their respective obligations.	Yes
Each party's rights regarding goods and services to be transferred can be identified.	Yes
The payment terms for goods and services to be transferred can be identified.	Yes
The contract must have commercial substance.	Yes
It is probable that the entity will collect the consideration to which it is entitled.	Yes

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #1 – RECAP

Have the 5 criteria been met? (ASC 606-10-25-1)

Criteria 5 – Am I giving my customer a price concession or is collectability not probable? (ASC 606-10-32-7)

Step 1

If a contract is modified, determine whether the modification is accounted for as a separate contract, a termination of an existing contract and creation of a new contract, or as part of the original contract (ASC 606-10-25-10 through 13)

Establish procedures to determine if contracts with the same customer or related party should be combined. (ASC 606-10-25-9)

When contract terms are implied or oral, consider documenting how the rights and obligations within the contract are legally enforceable

Revenue from Contracts with Customers
Step 2

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS

Definition of performance obligation

A performance obligation is a promise to provide goods or services (or a bundle of goods or services) that are either:

i. Distinct

ii. Homogenous, and both:

- Each distinct good or service is a performance obligation satisfied over time (refer to Step #5), and
- The same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service to the customer (refer to Step #5).

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS

Definition of a ‘distinct’ good or service

Can the customer benefit from the good or service, either on its own, or with other readily available resources?

(‘readily available resources’ are those that the customer possesses or is able to obtain from the entity or another third party)

No → **The good or service is not ‘distinct’**

(these are then grouped into ‘bundles’ of goods and services that are themselves ‘distinct’)

Yes ↓

Is the promise to transfer a good or service separate from the other promised goods or services in the contract? Indictors may include:

- **The entity does not provide a significant service of integrating the goods and services**
- **A good or service does not significantly modify or customize the other goods and services**
- **A good or service is not highly dependent or interrelated with the other goods and services**

No → **The good or service is not ‘distinct’**

Yes ↓

The good or service is distinct

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS

Example - Membership Dues

- A $5 donation toward the scholarship fund for students who are pursuing a career in science
- The promise to the member to provide legislative advocacy services during the one-year term
- The promise to provide access to the members-only section of the nonprofit's website
- The promise to the member of a subscription to provide 4 quarterly scientific journals

How many promises are there in this contract?

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS

Promise	Criteria 1	Criteria 2
Legislative Advocacy	No	Yes
Website Access	No	Yes
Quarterly Journals (4)	Yes	Yes

Criteria 1: Can the customer benefit from the good or service, either on its own, or with other readily available resources?

Criteria 2: Is the promise to transfer a good or service separate from the other promised goods or services in the contract?

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS
MEMBERSHIP DUES – EXAMPLE RECAP

- What are the final performance obligations?

Membership Benefits

Q1 Scientific Journal

Q2 Scientific Journal

Q3 Scientific Journal

Q4 Scientific Journal

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – IDENTIFY SEPARATE PERFORMANCE OBLIGATIONS
OPTION TO ACQUIRE ADDITIONAL GOODS OR SERVICES AND MATERIAL RIGHTS

- An option to acquire additional goods and services in a contract is a performance obligation only if the option provides a material right to the customer that the customer would not receive without entering into the contract.
- If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #2 – RECAP

Step 2

Identify the performance obligations: (1) goods or services that are distinct and (2) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. (ASC 606-25-14)

Goods or services are distinct if (1) the customer can benefit from the good or service on its own and (2) the promise to transfer the good or service is separate from the other promised goods and services in the contract (ASC 606-10-25-19)

Options to purchase additional goods or services (material rights) ASC 606-10-55-41)

Are there third parties (i.e. principal vs. agent considerations) ASC 606-10-55-36 through 40)

Implied obligations (ASC 606-10-25-2)

Immaterial performance obligations (ASC 606-10-25-16)

Are there sales with a right of return? (ASC 606-10-55-22 through 29)

Revenue from Contracts with Customers
Step 3

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Definition – Transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

- Excluding amounts collected on behalf of third parties – e.g. sales taxes etc.

The consideration promised in a contract with a customer can vary in terms of nature and timing, and this affects the determination of the transaction price.

Specific consideration is given to:

i. Variable consideration (including constraints on estimates of variable consideration)
ii. The existence of a significant financing component in the contract
iii. Non-cash consideration
iv. Consideration payable to a customer.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Variable consideration

Variable consideration can arise due to:

- Discounts, rebates, refunds, and credits
- Price concessions, incentives, and performance bonuses
- Penalties
- Consideration that is contingent on the occurrence or non-occurrence of a future event.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

We Have Variable Consideration – Now What?

- When there if variable consideration, the transaction price must be estimated.
- There are two methods that can be used to estimate the variable consideration

(i) Expected value method	(ii) Most likely amount
i.e. the sum of the probability weighted amounts for a range of possible outcomes. *(Appropriate where there are a larger number of contracts with similar characteristics)*	**i.e. the single most likely amount out of a possible range of outcomes.** *(Appropriate where there are only two possible outcomes)*

- One method should be applied consistently throughout the contract
- Consider all the information that is reasonably available (historical, current, and forecast) to come up with a reasonable number of possible consideration amounts.
- The estimate of variable consideration needs to be updated at each reporting date.

REVENUE FROM CONTRACTS WITH CUSTOMERS

EXAMPLE

Membership Dues

- Membership application is signed by the member and ABC nonprofit on 1/1/2019
- The price of the membership is $500 per member per year which include:
  - A $5 donation toward the scholarship fund for students who are pursuing a career in science (non-refundable)
  - The promise to the member to provide legislative advocacy services during the one-year term
  - The promise to provide access to the members-only section of the nonprofit's website
  - The promise to the member of a subscription to provide 4 quarterly scientific journals
- The scientific journals are sold in bookstores and online for $20 per journal
- **The Member receives a 5% discount ($25) if the dues are paid by 1/15/2019.**

REVENUE FROM CONTRACTS WITH CUSTOMERS

EXAMPLE

Membership Dues

What is the transaction price in our ongoing example?

Transaction Price = $495

Do we have variable consideration?

Yes, a 5% Discount.
$495 * 5% = $25

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Constraining the estimate of variable consideration

ASC 606 limits (i.e. 'constrains') the estimate of variable consideration only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur….'

Assessment of this constraint requires judgment, in considering both:

- The probability of a change in variable consideration
- The magnitude of that change in variable consideration.

Factors that may indicate a significant revenue reversal may occur include:

- Extent of factors that are outside the control of the entity (i.e. market volatility)
- Uncertainty in the estimate is not expected to be resolved in the short-term
- The entity's practice and/or experience with similar contracts
- The is a larger number and broad range of possible consideration amounts.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Refund Liability

- In some contracts, an organization transfers control to the customer and grants the customer a right of return for various reasons. Examples include:
  - A full or partial refund of any consideration paid
  - A credit that can be applied against amounts owed, or that will be owed to the entity
  - Another product in exchange

- A refund liability is recognized if an organization receives consideration from a customer and expects to refund some or all of that consideration to the customer.

- Measured at the amount of consideration received or receivable for which the entity does not expect to be entitled (amounts that are not included in the transaction price).

- The refund liability must be updated at the end of each reporting period for any changes in the likelihood and magnitude of the refunds.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Is the amount of consideration fixed or variable?

Variable

Estimate the amount of variable consideration using either (1) the most likely amount method or 2) the expected value method.

Determine the amount of variable consideration, if any, where it is probable that a significant reversal in the amount of cumulative revenue will NOT occur when the uncertainty associated with the variable consideration is subsequently resolved.

Fixed

Include the amount in the transaction price

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Significant Financing Component

- Takes into account the time value of money
- The objective is for the entity to recognize revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (that is, the cash selling price)
- Discount Rate
  - Determine at contract inception based on credit characteristics of the party receiving the credit
  - Generally not updated for changing circumstances

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – DETERMINE THE TRANSACTION PRICE

Significant Financing Component

- Practical Expedient:
  - At the inception of the contract, if the entity expects the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service to be one year or less, then the entity does NOT need to factor in a financing component.
- No significant financing component – 3 factors

The customer paid for the goods or services in advance, and the timing of transfer of the goods or services is at the discretion of the customer.
A substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration is outside the control of the customer or the entity.
The difference between the amount of promised consideration and the cash selling price of the promised goods or services arises for non-finance reasons.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #3 – RECAP

What type of consideration does the contract have – fixed or variable?

Consider the constraint outlined in 606-10-33-11 & 12 with respect to variable consideration (to prevent subsequent cumulative revenue reversals)

Determine if there is a significant financing component (ASC 606-10-32-15 through 20)

Step 3

For variable consideration, consider the two methods of estimation (1) expected value method & (2) most likely amount method (ASC 606-10-32-8)

Determine if there is any non-cash consideration (ASC 606-10-32-21 through 24)

Determine if there is consideration payable to the customer (ASC 606-10-32-21 through 24)

Consider refund liabilities (ASC 606-10-32-10)

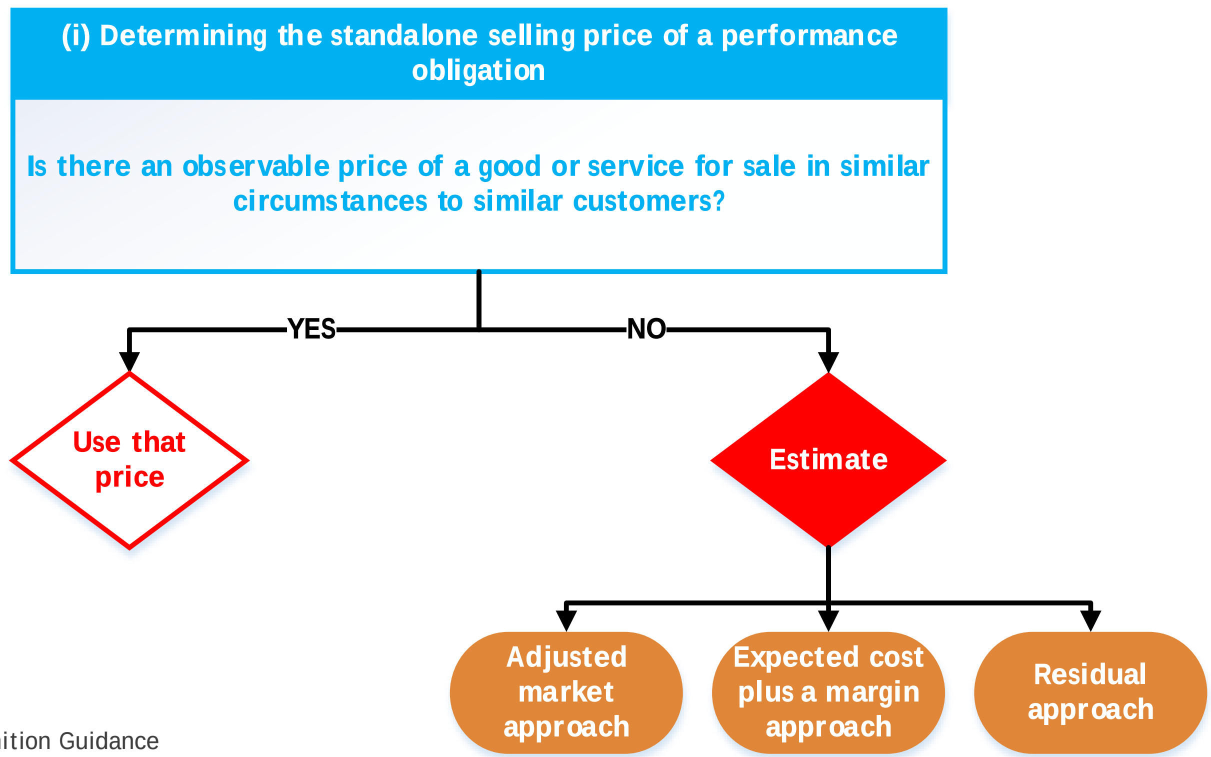
Revenue from Contracts with Customers
Step 4

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

An entity allocates/splits the transaction price (determined in Step #3) between its performance obligations (identified in Step #2).

The allocation is based on the relative 'standalone selling prices' of each identified performance obligation, being: *'The price at which an entity would sell a promised good or service separately to a customer'*



REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Methods of determining the standalone selling price

Adjusted market approach	Expected cost plus a margin approach	Residual approach
• Estimate the price customers in the market would be willing to pay • Consider reference to competitors prices for similar goods and services	• Forecast the expected costs and then add an appropriate margin.	• Total transaction price less the **observable** standalone selling prices of other performance obligations*

* In order to use residual approach, the criteria below must be met:

i. The selling price varies significantly (the same good or service is sold at the same time to other customers for a very broad range of prices)

ii. The selling price is uncertain (selling price has not yet been established and the good or service has not previously been sold on a standalone basis).

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Discounts - determining allocation

Discounts exist where the sum of the standalone selling prices exceed the promised consideration.

Allocation of the discount is made to either:

i. Specific performance obligation(s)

ii. Proportionately between all performance obligations.

'Specific' allocation (i) occurs only if there is observable evidence that both:

- There are regular sales, on a standalone basis, of the (bundle) of goods or services
- The sales of the (bundle) of goods or services are regularly priced at a discount.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Example – Determining Standalone Price

Answer - The standalone selling price for each journal would be the observable price of $20, since that is the price at which the NFP separately sells the journals to customers.

Performance Obligations	Standalone selling price
1 Quarterly Journal	$ 20
2 Quarterly Journal	20
3 Quarterly Journal	20
4 Quarterly Journal	20
5 Membership benefits	?
Total	**$?**

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Example – Allocating Transaction Price

The NFP does not sell membership separately without including the quarterly journals. Since there is no directly observable selling price, the NFP should estimate the standalone selling price. The NFP determines that the adjusted market assessment approach is a suitable method to use to estimate the standalone selling price for the membership.

Performance Obligations	Standalone selling price	Percentage
1 Quarterly Journal	$ 20	4%
2 Quarterly Journal	20	4%
3 Quarterly Journal	20	4%
4 Quarterly Journal	20	4%
5 Membership benefits	470	84%
Total	**$550**	**100%**

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Example - Allocating Transaction Price

The NFP would then allocate the transaction price to the performance obligations based on the relative standalone selling price as follows:

Performance Obligations	Allocated Transaction Price
1 Quarterly Journal	$ 20
2 Quarterly Journal	20
3 Quarterly Journal	20
4 Quarterly Journal	20
5 Membership benefits	415
Total	**$495**

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE DISCOUNT TO PERFORMANCE OBLIGATIONS

Example – Allocation methodology and discounts

Answer: The discount is allocated proportionately to all of the products (5% of total membership benefits $495 = $25):

Performance obligation	Allocated transaction price %	Allocated Discount
1 Quarterly Journal	4%	$1
1 Quarterly Journal	4%	$1
1 Quarterly Journal	4%	$1
1 Quarterly Journal	4%	$1
Membership benefits	84%	$21
Total		$25

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Variable consideration - determining allocation

The allocation of variable consideration (including changes in the estimate of variable consideration) will vary and may be allocated to either:

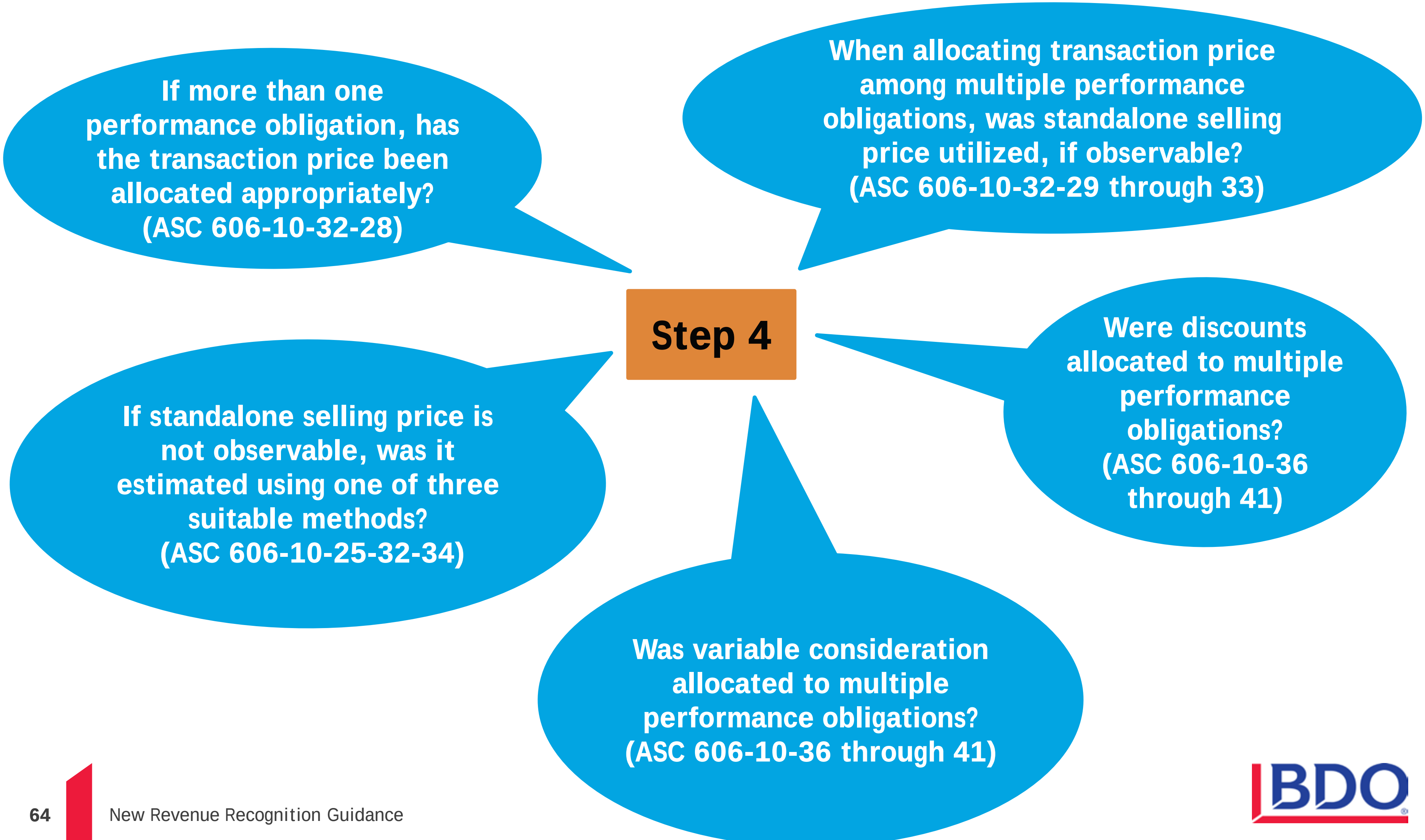
i. The entire contract
ii. One or more (but not all) performance obligations (e.g. bonuses)
iii. One or more (but not all) goods or services within a single performance obligation (e.g. CPI adjustments for year 2 in a two year maintenance contract).

Variable consideration is allocated to (ii) or (iii) above if both:

- It relates specifically to the satisfaction of the performance obligation or transfer of the goods or services
- Allocation is consistent with the overall allocation principle.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #4 – RECAP



Revenue from Contracts with Customers
Step 5

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

Revenue is recognized as/when a nonprofit satisfies each performance obligation. Satisfaction occurs as/when a nonprofit transfers 'control' of the goods or services to the customer.

'Control' is the ability to direct the use of and obtain substantially all of the remaining benefits from an asset (or prevent others from doing so).

Revenue is recognized either:

(i) Over time	(ii) At a point in time
Subject to various criteria under ASC 606	**If the criteria for recognition over time under ASC 606 are not met.**

The two approaches are mutually exclusive.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Recognize revenue over time

Criteria:

1 ***The customer simultaneously receives and consumes all of the benefits provided by the entity's performance as the entity performs***

2 ***The asset that is created or enhanced is controlled by the customer***

3 ***(a) The entity's performance does not create an asset with an alternative use to the entity & (b) there is an enforceable right to payment for performance completed to date***

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Recognize revenue over time

Criteria (i) - The customer simultaneously receives and consumes all of the benefits provided by the entity's performance as the entity performs

A customer simultaneously receives and consumes all of the benefits provided as the entity performs, where:

- Another entity would not need to re-perform the work already completed to date to fulfill the remaining performance obligation, and
- The entity's work does not create an asset (i.e. WIP inventory).

In practice, it is likely that only (some) service contracts would satisfy this criteria (i.e. not goods contracts).

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Recognize revenue over time

Criteria (ii) - The asset that is created or enhanced is controlled by the customer

An entity needs to consider the indicators of whether control has been transferred as noted on the previous slide, i.e. whether:

i. Is there a present right to payment for the asset?
ii. Who has legal title to the asset?
iii. Has physical possession of the asset been transferred?
iv. Have the significant risks and rewards of ownership been transferred?
v. Has there been acceptance of the asset by the customer?

Note: This approach is similar to the rationale of the 'percentage of completion method' under ASC 605-35 for construction contracts (i.e. that there is a continuous sale and that the customer controls the work in progress).

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Recognize revenue over time

Criteria (iii) - The entity's performance does not create an asset with an alternative use to the entity

An entity has an alternative use for the asset if it can readily redirect the use of the asset, both:

- Contractually, and
- Practically.

If the asset can be readily interchanged with other assets produced by the entity, then there is no substantive **contractual** restriction preventing the redirection of the specific asset being produced (i.e. generic 'widgets').

If there is either no substantial cost on rework, or no substantial loss on sale of the asset to another customer for the asset in its current state, then there is no **practical** restriction preventing the redirection of the specific asset being produced.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Recognize revenue over time

Criteria (iii cont'd) - There is an enforceable right to payment for performance completed to date

Enforceability

Consider whether, in similar circumstances, legislation or legal precedent confers rights to payment:

- Exist, even though they are not included in the contractual agreement
- Do not exist, even though they are included in the contractual agreement.

Also consider the entity's business practices in choosing whether to pursue rights to payments.

Payment for performance completed

The amount:

- Need not be fixed, however, must at least compensate the entity for performance to date
- Must approximate goods or services transferred to date (not merely compensation for loss of profit)

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

OVER TIME

Question: For revenue recognized over time, how is progress towards completion of the performance obligation determined?

The method used as the basis of revenue recognition over time must reflect the pattern of how the goods or services are transferred to the customer.

These methods are broadly categorized as being either:

i. **Output** methods (i.e. results, milestones, units produced/delivered etc.)

ii. **Input** methods (i.e. resources consumed, labor/machine hours, costs incurred etc.)

Note: Must exclude from these methods any measure relating to goods or services that have not been transferred to the customer.

Note: Only one method per performance obligation can be used, and application must be consistent for similar performance obligations.

Note: Subsequent changes in the method used are a change in **estimate**.

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

POINT IN TIME

Recognize revenue at a point in time

- **Recognize revenue at a point in time if criteria for recognition over time are not met**
- **Indicators to be considered when determining whether control has been transferred to the customer include:**

(i) Is there a present right to payment for the asset?

(ii) Who has legal title to the asset?

(iii) Has physical possession of the asset been transferred?

(iv) Have the significant risks and rewards of ownership been transferred?

(v) Has there been acceptance of the asset by the customer?

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECOGNIZE REVENUE

Example – Membership Dues – Recognize Revenue

Performance Obligations	Allocated Transaction Price	Allocated Discount	Revenue to Recognize
1 Quarterly Journal	$ 20	$ 1	$ 19
2 Quarterly Journal	20	1	19
3 Quarterly Journal	20	1	19
4 Quarterly Journal	20	1	19
5 Membership benefits	415	21	394
Total	**$495**	**$25**	**$470**

The member simultaneously receives and consumes the benefits of membership and the membership performance obligation is satisfied over time (i.e. $394 ratably over the one-year membership period)	**Over Time**
The performance obligation for each quarterly journal is satisfied at a point in time and revenue should be recognized when control of the journal has been transferred to the customer (i.e. $19 upon shipment)	**Point In Time**

REVENUE FROM CONTRACTS WITH CUSTOMERS

STEP #5 – RECAP

Revenue should be recognized once performance is satisfied by transferring good or service to customer who obtains control
(ASC 606-10-25-23)

Was one of the three criteria met in order for revenue to be recognized over time?
(ASC 606-10-25-27)

Step 5

If criteria was not met to recognize revenue over time, does the NFP satisfy a performance obligation at a point in time?
(ASC 606-10-25-30)

For revenue recognized over time, did NFP utilize input or output methods appropriately?
(ASC 606-10-25-27)

For revenue recognized at a point in time, were the 5 indicators considered in determining if control had been transferred?

How to Get Ready

7 Ways to Prepare for and Implement the New Revenue Recognition Standard

To make sure that your organization is adequately prepared for implementation of the new revenue recognition standard, you should consider taking the following seven proactive steps:

1 Become familiar with the new standard, discuss the new standard with your accounting advisors and evaluate the impact the standard will have on all facets of your organization's revenue streams.

2 Inventory all current revenue streams and evaluate whether there are differences between current practices and the new standard. Organizations should also consider the potential effect of these differences on their financial statements.

7 Ways to Prepare for and Implement the New Revenue Recognition Standard

3 Evaluate whether there are differences between current practices and the new standard on how you address contract modifications.

4 Reconsider whether revenue will be recognized over time or at a point in time based on both the new criteria and specific guidance for licenses or other multi-year contracts. Systems, processes and controls may need to be updated as a result of the new criteria and any changes in the timing of revenue recognition.

5 Historically, many nonprofits have not tracked costs to acquire a contract, namely because they have been expensed as incurred. To maintain compliance with the new standard, nonprofits will need to consider necessary resources for accumulating costs incurred that need to be capitalized.

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❼ Ways to Prepare for and Implement the New Revenue Recognition Standard

❻ Identify data gaps between what is presently available and what will be needed for the required disclosures in the new standard.

❼ Nonprofits may want to consider preparing mock-up financial statements to understand the impact of the new standard, as well as begin the education process of their boards and other financial committee members.

ASC 606 Implementation Process – December 31, 2019 Year-Ends (Non-Public)

PHASE 1 - SCOPING AND GAP ANALYSIS

Take an inventory of revenue streams identifying those to be impacted. Prepare a "gap analysis" of ASC 605 vs. ASC 606 for those revenue streams addressing:

- TRANSITION METHOD/ISSUES
- 5 STEPS OF ASC 606
- CONTRACT COSTS
- DISCLOSURES

PHASE 2 - TECHNICAL ANALYSIS

Determine specific application of issues identified in Phase 1, including method of determining standalone selling price, pricing controls, identifying specific contracts costs to be capitalized, amortization periods and methodologies and lookback periods for revenue contracts and contract costs. Identify broad systems and business process requirements.

PHASE 3 - SYSTEMS CONFIGURATION AND BUSINESS PROCESSES

Reconfigure systems and business processes based on Phase 2 findings.

PHASE 4 - TESTING/TRANSACTION AUDITING INTERNAL CONTROLS

Run historical transactions through parallel systems and business processes reconfigured for ASC 606. Auditors to perform detail transaction testing.

PHASE 5 - FINANCIAL REPORTING AND DISCLOSURES

Assess results of Phase 4, record ASC 606 adoption entries and develop disclosures including contract liability rollforwards, summary of remaining performance obligations, etc.

Timeline

- Jan-April 2018
- May -Sept 2018
- Oct-Dec 2018
- Jan-April 2019

ASC 606 Implementation Process – June 30, 2020 Year-Ends (Non-Public)

Timeline

PHASE 1 - SCOPING AND GAP ANALYSIS

July-Oct 2018

Take an inventory of revenue streams identifying those to be impacted. Prepare a "gap analysis" of ASC 605 vs. ASC 606 for those revenue streams addressing:

- TRANSITION METHOD/ISSUES
- 5 STEPS OF ASC 606
- CONTRACT COSTS
- DISCLOSURES

PHASE 2 - TECHNICAL ANALYSIS

Determine specific application of issues identified in Phase 1, including method of determining standalone selling price, pricing controls, identifying specific contracts costs to be capitalized, amortization periods and methodologies and lookback periods for revenue contracts and contract costs. Identify broad systems and business process requirements.

PHASE 3 - SYSTEMS CONFIGURATION AND BUSINESS PROCESSES

Nov 2018 – Mar 2019

Reconfigure systems and business processes based on Phase 2 findings.

PHASE 4 - TESTING/TRANSACTION AUDITING INTERNAL CONTROLS

April – June 2019

Run historical transactions through parallel systems and business processes reconfigured for ASC 606. Auditors to perform detail transaction testing.

PHASE 5 - FINANCIAL REPORTING AND DISCLOSURES

July – Oct 2019

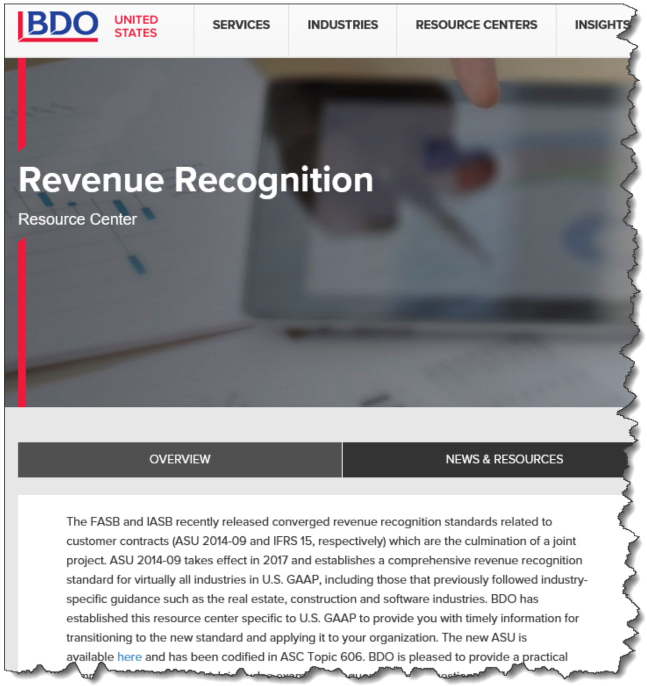
Assess results of Phase 4, record ASC 606 adoption entries and develop disclosures including contract liability rollforwards, summary of remaining performance obligations, etc.

Resources

Revenue – BDO Resources

BDO Revenue Resource Center

https://www.bdo.com/services/assurance/revenue-recognition/overview


The FASB and IASB recently released converged revenue recognition standards related to customer contracts (ASU 2014-09 and IFRS 15, respectively) which are the culmination of a joint project. ASU 2014-09 takes effect in 2017 and establishes a comprehensive revenue recognition standard for virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. BDO has established this resource center specific to U.S. GAAP to provide you with timely information for transitioning to the new standard and applying it to your organization. The new ASU is available here and has been codified in ASC Topic 606. BDO is pleased to provide a practical

Updated Newsletter

https://www.bdo.com/insights/assurance/fasb/fasb-newsletter-march-2017


MARCH 2017
www.bdo.com

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: FASB

TOPIC 606, REVENUE FROM CONTRACTS WITH CUSTOMERS

Introduction

In 2014, the FASB issued its landmark standard, *Revenue from Contracts with Customers*.[1] It is generally converged with equivalent new IFRS guidance and sets out a single and comprehensive framework for revenue recognition.[2] It takes effect in 2018 for public companies and in 2019 for all other companies, and addresses virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. For many entities, the timing and pattern of revenue recognition will change. In some areas, the changes will be very significant and will require careful planning.

The new standard also introduces an overall disclosure objective together with significantly enhanced disclosure requirements for revenue recognition. In practice, even if the timing and pattern of revenue recognition does not change, it is possible that new and/or modified processes will be needed in order to comply with the expanded disclosure requirements.

CONTENTS

Read more

Questions?