Are Grants Subject to Revenue Recognition?

Many nonprofit organizations receive grants and contracts from federal, state and local governments and other funding sources such as foundations. The most recent BDO Nonprofit Benchmarking Survey reveals that 45 percent of organizations say the time and effort required to deal with regulatory and legislative changes pose a moderate- or high-level challenge.

Key financial players such as CFOs and Controllers are facing a fast-approaching deadline to implement new revenue recognition requirements (Topic 606). The revenue standard aims to improve accounting for contracts with customers, but it also introduces a layer of complexity and challenge to nonprofits of every size. Contributions, defined as an unconditional transfer of cash or assets in a voluntary non-reciprocal transfer, are scoped out of revenue recognition. Exchange transactions—a reciprocal transaction in which two parties exchange something of commensurate value—are within the scope and need to be accounted for following the new revenue recognition requirements.

Therefore, a standardized practice of identifying if the grant is a contribution or exchange transaction is the key to proper revenue recognition.

On June 21, 2018, the FASB released a final accounting standards update (ASU), *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. It clarifies how grants and other contracts are classified as either an exchange transaction or a contribution. The clarified guidance aims to help nonprofits complete that first step in a consistent way across the sector.

Practical Example: How to evaluate a grant under the new guidance
Description of 'Nonprofit A': A large research association that specializes in space exploration. Their mission is advancing scientific discoveries and supporting the advancement of new technology. The organization receives funding from various individuals, corporations, and governments to support its efforts.

Description of the grant: Nonprofit A received a $15 million grant from the federal government to finance the costs of a research initiative to test the effectiveness of newly developed technology.

How should Nonprofit A classify the $15 million grant?
This grant could be classified as either an exchange transaction or a contribution, depending on the exact parameters of the funding. Let's examine both scenarios:

	Classify the grant as an **exchange transaction** if:	Classify the grant as a **contribution** if:
Specific provisions of the grant	The resources are paid by the federal government as the work is incurred (cost reimbursement) and request for payment is submitted. The federal government specifies the protocol of the testing, material the technology is made of, and the type and duration of testing that must take place. The federal government requires a detailed report of the test outcome within two months of its conclusion and any intellectual property (IP) as a result of the grant belongs to the federal government.	Nonprofit A makes all decisions about research protocol, material the technology is made of, and the type and duration of testing that must take place. In addition, the nonprofit retains all the commercial rights for any IP that is developed as a result of the research. Nonprofit A still has to produce the detailed report of the test outcome within two months.
Deciding factor: Reason for classifying the grant as an exchange transaction or contribution	This example would be an exchange transaction because of how prescriptive the grant is, and because the government owns the IP. Therefore, in this case **the federal government is receiving something of commensurate value.**	In this scenario, the transaction would be considered a contribution because there is **no commensurate value being exchanged.** Even though Nonprofit A is expected to produce a report, the FASB does not consider this an equal

		exchange of value. The ASU deems filing this type of specified report to be administrative in nature and not a performance standard.
Is the grant subject to the new revenue recognition standard?	Yes. All exchange transactions are subject to revenue recognition.	No. The above scenario is a conditional contribution, which is not subject to revenue recognition. The condition is met as the work is incurred in accordance with the grant agreement. Determining whether a grant is conditional or unconditional can be difficult. The ASU states that determining if a donor-imposed condition exists is the key to determining when the contribution can be recognized as revenue. The first consideration is whether the grant agreement has a right-of-return requirement in which grantee must return to the promisor (grantor) assets transferred as part of the agreement or a right to release of the promisor from its obligation to transfer assets. The scenario in the above does not meet any of these requirements. Additionally, the ASU has provided the following indicators that could create a barrier and make the grant conditional: • The inclusion of a measurable performance-related barrier or other measurable barrier • Whether a stipulation is related to the purpose of the agreement • The extent to which a stipulation limits discretion by the recipient

Disclaimer: *These examples are referenced from the BDO Blog written by Lee Klump, June 21, 2018. They are for illustrative purposes only. Changing even one fact in the example could significantly change the accounting treatment.*

What types of organizations need to take action?

- **Grantees:** All nonprofits that receive grants from foundations, governments, or other funding entities will need to assess how they are accounting for contributions. College, universities, research institutions, and social services organizations that rely heavily grants and contracts could see the greatest impact.
- **Grantors:** Non-governmental organizations like public and private foundations, as well as for-profit entities that issue grants to nonprofits, will need to think about how they write their grants and contracts.

What organizations will not experience a significant impact?

- **Public charities:** As organizations that derive the bulk of their funding from individual contributions, they will be less impacted by this guidance.
- **Local, state, and federal governments:** Nonprofits will still need to assess how they classify federal and state funding, but governmental bodies are not within the FASB's scope and do not need to comply with this guidance. Governments are subject to standards issued by the Governmental Accounting Standards Board (GASB).