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Local Council Audit and Accounting Alert 2019

New Accounting Standards to Affect Your 2019 Audit!

Two new accounting standards become effective this year, and both have to do with revenue recognition. FASB ASU 2014-09 focuses on revenue from the transfer of goods or performance of services (exchange transactions), and FASB ASU 2018-08 helps nonprofits identify whether a grant is a contribution or an exchange transaction, and if it *is* a contribution, whether the contribution is conditional or unconditional. We'll break down each of these new standards so you will *be prepared* for your upcoming audit.

Please review this document with your accounting staff, audit committee, and auditors. There's a lot to cover but it will be well worth your while. Taking the time now to understand the impact of these new accounting standards on your financial statements will save your auditors time and ultimately save you money.

FASB ASU 2014-09, *Revenue from Contracts with Customers* *(FASB Accounting Standards Codification (ASC) Topic 606)*: This new accounting standard effectively eliminates the previous transaction-specific and industry-specific revenue recognition guidance and replaces it with a principles-based approach for determining an entity's revenue recognition policies. At the heart of the new revenue recognition standard is the concept that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. Fortunately, the new standard does not cover all revenue streams—only those that result from exchange transactions. Some revenue streams are not subject to the new rules, so you can relax (a little). Here's a list:

- Contributions (including in-kind gifts)
- Split-interest agreements
- Event sponsorships
- Rent revenue (including rent revenue from National Scout Shops)
- Investment income
- Insurance contracts

Contributions are not exchange transactions (they are nonreciprocal transfers) and are covered by a separate subtopic of the FASB ASC (958-605).

Split-interest agreements, such as charitable remainder trusts and charitable gift annuities, are also nonreciprocal transfers and are covered by FASB ASC 958-30.

Event sponsorships result in minimal benefit to the sponsor (as long as they don't advertise the sponsor's product or service) so payments to the council are considered to be contributions.

Rent revenue, including rents received from the national organization for NDC-owned Scout Shops, is covered under the *Leases* topic of the FASB ASC.

Investment income and *insurance contracts* are excluded from ASU 2014-09.

What *is* covered by the new revenue recognition standard?
For local councils, here are some of the revenue streams covered by ASU 2014-09:

- **Scout Shop and Trading Post sales** (for council-owned Scout Shops)
- **Product sales** (popcorn, peanuts, etc.)
- **Camping and activity revenue**
- **Special fundraising event revenue**—the exchange component
- **Grants that are exchange transactions** (unlikely for local councils—covered later)

The good news here is that, for the most part, *current practices will not change as a result of FASB ASU 2014-09...*however…you must be able to show your auditor that you have carefully considered the new standard's effect on all of your exchange transaction revenue streams. The only way to do this is to apply the standard's provisions to each revenue source, one by one.

FASB ASU 2014-09 outlines a five-step process for recognizing revenue from exchange transactions:

1. *Identify the contract with the customer—can be written, oral, or implied.*
2. *Identify the performance obligations in the contract.*
3. *Determine the transaction price.*
4. *Allocate the transaction price to the performance obligations in the contract.*
5. *Recognize revenue when (or as) the council satisfies a performance obligation.*

Let's apply this process to each of the council revenue streams listed above:

Scout Shop and Trading Post sales—For Scout Shop and Trading Post (TP) sales and most retail transactions, application of the five-step process is straightforward. Identification of the contract (step 1) is obvious—the Scout Shop/TP offers to sell merchandise in exchange for money, to customers who want to buy it. According to ASU 2014-09, a contract must be approved, create an enforceable right and obligation, have

commercial substance, and collection must be probable. All of these elements are met at checkout. The performance obligation (step 2) is the purchase of the good. The transaction price (step 3) is already established (and usually attached to the product). As each item is individually priced, no allocation (step 4) is necessary. Finally, revenue is recognized (step 5) as the customer pays and takes possession of the merchandise. The sales transactions are recorded in the point-of-sale system, and then in the council's general ledger via a data interface or manual journal entry.

Special note: Because some Scout Shop/TP merchandise is sold with a *right of return*, you will need to estimate a liability at year end, offset by sales revenue, for probable customer returns. For most councils, this will likely be immaterial to the financial statements.

Product sales—Much of the guidance contained in the Scout Shop sales topic above can be applied to product sales as they are retail transactions. For Trail's End popcorn sales, however, the sales process differs in that BSA units generally place their orders online through the Trail's End website and delivery occurs at predetermined times and locations. In addition, BSA units are (usually) allowed to purchase popcorn "on account" with payment due at a later date. As a part of the contract identification element of ASU 2014-09 (step 1), the council is required to assess the probability of collecting these accounts receivable in order to determine whether there is a substantive transaction between the council and the unit—a condition necessary for revenue recognition under the new rules. In making this collectability assessment, the council will need to exercise judgment and consider all facts and circumstances, including its knowledge of the customer. The performance obligation (step 2) is delivery of the product, the transaction price is established by the council (step 3), and each item is individually priced so no allocation of the transaction price (step 4) is required. Revenue recognition (step 5) should occur when the product has been delivered. Local councils can use reports from their Trail's End online accounts to record gross sales, cost of product, unit commissions, inventory and accounts receivable. One important thing to note here is that many BSA units have the right to return to the council any unsold product. For local councils that offer to do this, they will set a product return-by date prior to year-end to ensure that the annual popcorn campaign is complete by that time. Should your council's popcorn campaign carry over into the new year and *probable* product returns exist at year end, you will need to accrue a liability for estimated returns. The debit would reduce sales revenue.

Camping and Activity revenue—Here, the contract element (step 1) is much the same as with Scout Shop and product sales, however, the performance obligation (step 2) is

delivery of the program rather than delivery of a product. For resident camps, fees are set by the local council (step 3) and include program supplies, meals, lodging, recognition items, staffing, and facility costs. As is customary, these items are never separately priced and are therefore considered to be one performance obligation (step 4). Note: some councils will offer "early bird" discounts on camp fees paid before a certain date. In this situation, the discount is factored into the transaction price. Some special camp programs do incur additional fees (shooting sports, for example), which are separately priced. BSA *activities* may involve program supplies, recognition items, and meals, and are also considered to be one performance obligation. Fees collected in advance of delivery of the camp or activity are initially recognized as liabilities (deferred revenue) and are only recognized (step 5) after delivery of the program has occurred. The BSA local council general ledger is set up to accommodate this process.

Special fundraising event revenue: Local council special events, such as FOS dinners and golf tournaments, present a special accounting challenge because revenue received from them is part contribution and part exchange transaction. The exchange portion of the transaction (which *is* covered by ASU 2014-09) is measured at the fair value of the direct donor benefit (e.g., the meal or round of golf). The contribution component (excluded from ASU 2014-09) is the excess of the "ticket price" over the fair value of the direct donor benefit. Steps 1 through 3 of the five-step revenue recognition process outlined in ASU 2014-09 are essentially the same as they are for camps and activities, except that donors understand that a portion of the event fee represents a contribution to the council. The performance obligation (step 2) is delivery of the dinner or round of golf, for example, which is usually accompanied by a presentation. The event fee or "ticket price" is set by the council (step 3). FASB ASC 2014-09 requires allocation of the transaction price (step 4) to the performance obligation(s). For special events, that means that the portion of the event fee attributable to the fair value of the meal or round of golf (i.e., the donor benefit) would need to be separately identified from the contribution portion and disclosed in the financial statements (Note: this is a new requirement, which we will discuss later).

Currently, 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 (step 5). For special event fees received *before* year-end for an event to occur *after* year-end, most councils follow AICPA guidance where the inherent contribution is conditioned on the event taking place and is therefore treated as a refundable advance along with the exchange transaction component.

Disclosures required by ASU 2014-09

The new standard requires local councils to disclose sufficient information to enable financial statement users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

The *Local Council Guide to the 2019 Audit (the Guide)* will contain downloadable sample footnote disclosures for ASU 2014-09 and ASU 2018-08! Look for the new Guide in late December.

Even though sample footnote disclosures will be made available to you in the 2019 *Guide*, take a look at the following disclosure requirements to see where you are going to need to "fill in the blanks". Under ASU 2014-09, councils should disclose qualitative (narrative) and quantitative (numeric) information about all of the following:

- *Contracts with customers*:
  - Revenue recognized from contracts with customers should be separately disclosed from other sources of revenue.

    Note: We believe that the council's statement of activities sufficiently segregates revenue from Scout Shop sales, product sales, and camps and activities from other revenue sources. For special event revenues, however, you will need to separate the contribution component from the exchange component and disclose it in the footnotes. This is a new requirement.

  - Impairment losses on receivables from contracts (e.g., bad debts on popcorn receivables) should be disclosed separately from impairment losses on other contracts.
- *Disaggregation of revenue*:
  - The revenue from these contracts should be sufficiently *disaggregated* into categories that help to inform financial statement users about how they are affected by economic factors. We believe that the presentation of these revenue streams in the council's statement of activities meets this requirement.
- *Contract balances*:
  - Disclosures are required for the opening and closing balances of receivables (popcorn A/R) and contract liabilities (deferred revenue from camps and activities and special events) from contracts with customers, if not otherwise separately disclosed.

    - Revenue recognized during the year that was included in the contract liability (deferred revenue) balance at the *beginning of the year* should be disclosed.
- *Performance obligations*—Disclosures should include a description of all of the following:
    - When the council satisfies its performance obligations (upon shipment, on delivery, etc.).
    - Significant payment terms.
    - Nature of the goods the council has promised to transfer.
    - Obligations for returns and refunds.
    - Types of warranties and related obligations.
- *Transaction price allocated to the remaining performance obligations*—Council disclosures should include:
    - The aggregate amount of the transaction price allocated to the performance obligations that are *unsatisfied* as of the end of the year.
    - An explanation of when the council expects to recognize the revenue disclosed in the preceding point above (can be a narrative or numeric disclosure).

      Note: Local councils that have not issued nor are conduit bond obligors for public-traded securities (i.e., most, if not all local councils) may elect *not* to provide the disclosures under this bullet point. If a council *is* subject to this disclosure, it only applies to contracts having a duration of *greater than one year.* Therefore, this disclosure would apply to certain camps and activities, and special events for which the council has collected fees more than one year in advance of their occurrence as of the reporting date. Philmont or a National Scout Jamboree are some examples of situations where a council might collect fees more than a year in advance of their occurrence.
- *Significant judgments used in applying this accounting standard*:
    - Councils should explain the judgments used in determining the timing of satisfaction of performance obligations. For local councils, performance obligations are generally satisfied at a point in time (rather than over a period of time). One exception would be for resident camps, which may occur over a one or two-week period. Although these technically occur over a period of time, they are completed within the reporting period. For Scout Shop sales and product sales, performance obligations are satisfied on delivery of the goods. Performance obligations for camps and activities

and special events are satisfied after delivery of the program or event. A council that has issued or is a conduit obligor for publicly traded securities must also include an explanation of the significant judgments made in evaluating *when* the customer obtains control of promised goods or services.

- Councils should explain the judgments used in determining the transaction price and amounts allocated to performance obligations. As discussed earlier, the only transaction price allocation by local councils involves allocation of special event fees to the fair value of the direct benefit to the donor (e.g., a meal or round of golf).

Transition guidance

We don't anticipate that adoption of ASU 2014-09 is going to have a material effect on local council financial statements, however choosing the right path can make the change easier. Two methods are available to councils for transitioning to the new guidance: The first method requires restatement of comparative periods presented, with expedients available to lighten the burden of a full restatement. The second method (recommended) avoids restating prior periods, but still requires a cumulative effect adjustment in 2019 beginning net assets. For most councils, we anticipate there will be no adjustment to beginning net assets required.

FASB ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* *(FASB ASC Topic 958)*: This new accounting standard is meant to help not-for-profit entities evaluate whether transactions should be accounted for as contributions or as exchange transactions and, if the transaction is identified as a contribution, whether it is conditional or unconditional. Each of these transaction types follows different guidance in the FASB ASC—contributions follow Topic 605 and exchange transactions follow Topic 606 (which we explored in the previous section).

Contribution or exchange transaction?

Distinguishing between exchange transactions and contributions is of particular significance to organizations that receive grants. ASU 2018-08 clarifies how an organization determines whether a *resource provider* (i.e., the provider of the grant—a foundation or government agency) is receiving *commensurate value* in return for the grant. If the resource provider *does* receive comparable (commensurate) value from the grant recipient (the local council, for example), then the transaction is an exchange transaction and would follow the guidance under ASU 2014-09 (FASB ASC Topic 606). If

no commensurate value is received by the grant maker, the transfer is a contribution. ASU 2018-08 stresses that the value received by the general public as a result of the grant is not considered to be *commensurate value* received by the provider of the grant (government agency or foundation) thus making the transaction nonreciprocal (in other words, a contribution). As a result of this new ASU, not-for-profit organizations will account for more grants/contracts/agreements as contributions and rather than exchange transactions. Here are some examples to help illustrate the concept:

- A foundation provides a $5,000 grant to a local council to provide the Scouting program to economically disadvantaged youth living in an urban area. In this situation, the benefit to the public as a result of the council's efforts does *not* constitute commensurate value received by the foundation. The payment is a contribution to the local council.
- A local government agency provides a $5,000 grant to a local council to conduct a study on academic performance by youth enrolled in the Scouting program compared with that of youth not enrolled in the program and requires the council to provide its findings in a written report to the government agency. The $5,000 represents the fair value of the study and report. The transaction is accounted for as an exchange transaction because the government agency has received comparable value in return for the study and report by the council.

Indicators to help in the evaluation of exchange transactions vs. contributions:

Exchange	Contribution
The intent of both parties is to exchange goods and services of comparable value.	Council solicits $ from the resource provider with no intent to provide comparable value to resource provider.
Both parties agree on the $ amount to be transferred in exchange for goods and services of comparable value.	Resource provider has complete control over the $ amount transferred to the council.
Contract provides for penalties in addition to $ already transferred for failure to perform.	Penalties for failure to comply with the contract terms are limited to $ already transferred and return of any unspent funds.

Conditional or unconditional?

You have just received a grant from a foundation and determined that it is indeed a contribution. Can you book it or not? You know that you are only supposed to book *unconditional* contributions but how can you be sure? ASU 2018-08 offers guidance in determining whether a contribution is *conditional.* According to the standard, to be

conditional, an agreement contains some kind of *barrier* that must be overcome *and* a right of return of assets (for a cash/property grant) or right to release a promisor's obligation (for a pledge). In plain English, that means you must accomplish something (overcome a hurdle—must be measurable) before you are entitled to the assets, and you have to give it back (or cancel the pledge) if you don't. For example, a council might receive a $50,000 grant conditioned on sending a *specified number* (measurable) of economically disadvantaged youth to summer camp. If the specified level of service is not achieved, then the money must be returned to the resource provider. If a *conditional* cash/property grant (contribution) is received, it should be initially recorded as a refundable advance (liability). It becomes unconditional when the *barrier* (the condition) has been overcome. If the conditional grant is a promise to give, it should not be recorded in the general ledger. Note: Conditional gifts/grants should not be confused with donor-imposed restrictions. A donor restriction on a contribution contains a stipulation on how or when contributed assets should be used. It does not specify a barrier that must be overcome before the recipient is entitled to the assets.

Disclosures required by ASU 2018-08

ASU 2018-08 does not impose any new recurring disclosures.

Transition guidance

The new standard provides for application of its provisions using the modified prospective method. Under modified prospective adoption, the provisions of ASU 2018-08 will apply to new grant and gift agreements entered into by local councils after January 1, 2019, including the remaining portions of any agreements from prior years that are incomplete as of that date. Prior year results are not restated. For most councils, we anticipate there will be no adjustment to beginning net assets required.

Other Goings On…

FASB votes to delay effective date of new Leases standard to 2021!

Local councils can breathe a sigh of relief as the FASB voted in mid-October to delay the effective date of *ASU 2016-02—Leases (FASB ASC Topic 842)* to fiscal years beginning after December 15, 2020. Before the October vote, it was to be effective for local councils (that have not issued nor are conduit bond obligors for public securities) in 2020. Look for detailed guidance on implementation of this important accounting standard in the coming months.

New format for the Statement of Functional Expenses

We have updated the format of the *PeopleSoft Financials* Statement of Functional Expenses to conform to the AICPA *Not-for-Profit Section* guidance for FASB ASU 2016-14—*Presentation of Financial Statements of Not-for-Profit Entities*. The AICPA model

includes certain costs, such as cost of goods sold and cost of direct donor benefits, within the functional matrix. Although the AICPA does not set generally accepted accounting principles (only the FASB does that), its functional expense model has become widely accepted. Look for an announcement, with examples, coming soon from the BSA Member Care Team. Of course, all of the topics discussed in this document will be covered in the *Local Council Guide to the 2019 Audit* coming later this year!