Nonprofit Navigator

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Conditional vs unconditional
New accounting standard clarifies
By Colette Kamps, CPA

One of the biggest areas of confusion in nonprofit accounting is with contributions: distinguishing them from exchange transactions, distinguishing them as restricted or conditional and distinguishing them as unconditional versus conditional. The determination can be especially perplexing as grant agreements may include language that is very unclear. In June 2018, the FASB issued Accounting Standards Update (ASU) 2018-08 to help clarify these issues. Here are some key points in the new ASU to assist with this.

The term “remote” is no longer included, and therefore, a probability assessment is not a factor. Under the current guidance, the use of the word “remote” has caused significant confusion when determining if there is a condition. In practice, nonprofits may have felt that certain stipulations in the agreement were very likely to happen (i.e. it was a remote chance they wouldn’t happen); so, they determined that the contribution was unconditional. By eliminating the word “remote,” this new guidance makes it much clearer that the focus in this determination is on whether there is a barrier to be overcome. Only trivial or administrative requirements (such as maintaining 501(c)3 status or submitting an annual report) would not indicate a barrier.

Indicators of a barrier included in this new guidance also help to differentiate between a restricted unconditional contribution and a conditional one. For example, a barrier may be performance-related, such as a stipulation that 1,000 meals must be served per week for the next three months as part of receiving a $10,000 grant.

Another indicator is when the nonprofit has limited discretion related to the barrier or stipluation. This would be a limit that is more specific than the general activities being conducted by the nonprofit or the time frame in which the contribution must be used. For example, limited discretion includes when a nonprofit has to follow a specific guideline for qualifying allowable expenses, or when the nonprofit has to hire specific individuals to conduct the activity.

In addition to the barrier requirement, a contribution is not conditional unless it also includes a right of the donor to receive their funds back if the barrier is not overcome. This right must be determinable from the agreement. So, does this mean we should see this exact type of wording in the agreement before we can conclude that the contribution is conditional? Not necessarily. If there is ambiguity about whether the donor would expect their funds returned to them, all facts and circumstances surrounding the contribution should be reviewed and/or the donor should be communicated with. If there is still ambiguity, it should be presumed that a promise containing stipulations that are not clearly unconditional is a conditional contribution.

The determination of conditional versus unconditional can affect the time period in which the contribution is recognized as revenue. So, considering this new clarified guidance, you may wish to communicate with your organization’s donors/grantors before a contribution or grant is awarded to be sure the agreement is worded in a way that allows for a clear determination.

If you have any questions, Colette can be reached at (480) 839-4900 or ColetteK@hhcpa.com.

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Are you ready for the new lease standard?
By Sharlynn Garza, CPA

You have probably heard about the changes to the lease accounting standards for years now. However, you may have pushed it out of your mind since the effective date seemed so far into the future. Well, I am here to tell you that it's quickly approaching. For nonpublic entities, including nonprofits, the new lease standard is effective for fiscal years beginning after December 15, 2019. If your fiscal year ends on June 30, the new lease accounting will be presented on your June 30, 2021 financial statement.

Transparency

The purpose of the new standard is to provide more transparency to the users of your financial statements. Under the current standards, operating leases are not included on an entity's financial statements. They are accounted for on a straight-line method and payments are expensed as they are made. Although operating leases are required to be disclosed in the footnotes, it is sometimes not very clear to the users what the total future obligations are under both capital and operating lease agreements. This new requirement to include lease obligations on the balance sheet as an asset and liability will hopefully make it clearer to the users regarding the total rights and obligations of an entity.

Comparability

The new standard will also help improve the comparability of each entity's financial statements. Under the old guidance, only capital lease obligations are required to be included on the balance sheet. However, to be classified as a capital lease, it must meet one of four required conditions. This methodology allowed some entities to structure lease agreements so that none of the conditions were met, thus avoiding the capital lease treatment. The new standard will help eliminate this by removing the criteria for deciding whether a lease should be classified as an operating or a capital lease. It will require all leases, except for a few types, to be included on the balance sheet of an entity's financial statements.

Applicability

This new standard is applicable to all existing leases currently in effect – not just those entered into after the effective date. Additionally, it requires retrospective presentation to all periods presented. So, if comparative financial statements are presented, this could first be seen on an entity's 2019 financial statements.

What should you be doing now to prepare? A good starting point would be to make a list of all your lease agreements. For each one, you should determine what impact it will have to your entity's financial statements. Going through this determination is particularly important if you have debt with lenders and need to discuss the potential impact to any existing loan covenants. The effective date is just around the corner and the time to act is now.

If you have any questions, Sharlynn can be reached at (480) 839-4900 or SharlynnG@hhcpa.com.

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