

Nonprofit Notes

Are You Classifying Contributions Correctly? *Conditions Versus Restrictions Explained*

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Misclassifying contributions remains a common issue for not-for-profit organizations, particularly as auditors and regulators continue to increase scrutiny of revenue recognition under Accounting Standards Codification (ASC) 958. Proper interpretation of and adherence to revenue recognition standards are key in order to communicate financial information to stakeholders.

Relevant Accounting Guidance

Guidance provided under ASC 958-605, Not-for-Profit Entities—Revenue Recognition, provides clarification as to how not-for-profit organizations can distinguish between conditional and unconditional promises to give. As a result of Accounting Standards Update (ASU) 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made, guidance is provided on the practical applications of revenue recognition principles for a not-for-profit organization. Under ASU 2018-08, the guidance clarifies whether or not the transaction is considered to be an exchange transaction, which is accounted for under ASC Topic 606, Revenue from Contracts with Customers, or a contribution, under which the provisions of ASC 958 are applicable.

Two criteria are applied to contribution transactions relating to revenue recognition:

Criteria 1 – Conditions and Timing of Revenue Recognition

Conditions in revenue recognition of contributions exist when both of the following requirements are met: a measurable barrier that must be overcome and a right of return (or right of release). Conditions primarily affect the timing of when revenue is recognized for a contribution transaction. If a transaction is deemed conditional, revenue is recognized as those conditions are satisfied and, if there are no conditions present, the transaction is considered unconditional and recognized immediately.

Measurable barriers involve clear, objective criteria for achieving a certain goal. This can be in the form of performance-related measures, measurable outcomes, limited discretion in usage of funds and requirements to incur qualifying expenditures.

Right of return (release) allows the grantor to require the recipient to return the transferred assets or allows the grantor to be released from its obligation to transfer additional promised assets.

Both a measurable barrier or barriers and a right of return (release) must be present in order for a contribution to be deemed conditional. A contribution that includes only one of these is not considered a conditional contribution for financial reporting purposes under ASC 958-605.

Criteria 2 - Restrictions (Net Asset Classification)

Both conditional and unconditional contributions can be classified either restricted or unrestricted. The purpose of a contribution is often explicit within the documentation supporting the transaction. Within this criteria are unrestricted net assets and donor-restricted net assets.

Unrestricted Net Assets

The revenue associated with these types of transactions is recognized immediately and recorded as unrestricted revenue.

Donor-Restricted Net Assets

There are three categories of donor restrictions within donor-restricted net assets – purpose restrictions, time restrictions and perpetual restrictions.

- Purpose restrictions – Broader in scope than conditions and often encompass programmatic usage of funds. These types of contributions would be considered purpose-restricted and not recorded as conditional, unless there were specific measurable barriers and a right of return/release was identified in the agreement.
- Time restrictions – Often relate to the passage of time such as payment schedules for the release of funding. An example is a contribution of \$1,000,000 to be paid out over the course of 5 years in the amount of \$200,000 per year. This type of transaction is an unconditional and time-restricted revenue item that would be included with donor-restricted net assets.
- Perpetual restrictions – These types of restrictions are usually associated with endowment transactions in which the principal balance is to be maintained indefinitely while the earnings are utilized for either general or specific donor-restricted purposes. These contributions are recognized immediately as they are not conditional, but the principal balance must be classified as donor-restricted indefinitely, whereas the earnings may or may not have a restriction associated with them.

Getting Classification Right Matters

The underlying agreement between the donor and the recipient must be reviewed carefully to distinguish between restrictions and conditions. It is important to note that these two dimensions are often related, but conditions and restrictions are separate concepts and applying these to revenue transactions must be done carefully in order to avoid misstatement of revenues and/or net asset balances.

Contact Us

Proper classification can be complex. Our [Not-for-Profit Services](#) team assists organizations in evaluating contribution agreements and maintaining compliance with ASC 958. If you have any questions, please contact your PKF O'Connor Davies client service team or:

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