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**DO YOU HAVE A  
WINNING FINANCIAL  
GAME PLAN?**

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**NEW REVENUE RECOGNITION REQUIREMENTS  
& BUDGETING BEST PRACTICES**

Not-for-Profit CPE Seminar Series September 7, 2017

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<b>STEVE HEERE</b> <i>Assurance &amp; Advisory Services Group</i> 412-338-9307 <a href="mailto:HEERE@GYF.COM">HEERE@GYF.COM</a>	<b>ROBIN RYAN</b> <i>Assurance &amp; Advisory Services Group</i> 412-338-9312 <a href="mailto:RYAN@GYF.COM">RYAN@GYF.COM</a>	<b>JASON HARDY</b> <i>Assurance &amp; Advisory Services Group</i> <b>412-338-9308 x-259</b> <a href="mailto:HARDY@GYF.COM">HARDY@GYF.COM</a>
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## NEW REVENUE RECOGNITION REQUIREMENTS FOR NON-PROFITS

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## TODAY'S OBJECTIVES

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- **Become familiar with new guidance**
- **Explore five steps to revenue recognition**
- **Consider implementation steps for all organizations**
- **Discuss NFP industry-specific issues and impact**

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## INTRODUCTION

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- **ASU No. 2014-09 – Revenue from Contracts with Customers**
- **Effective dates**
  - *For nonpublic companies, years beginning after 12/15/18*
  - *Ex: January 1, 2019, July 1, 2019*
- **Early adoption is permitted**

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## APPLICABILITY

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- **Applies to all entities – public/private, for-profit/non-profit**
- **Pertains to contracts with customers**
  - *Contributions are excluded from the scope*
  - *Leases, financial instruments and certain other specific types of contracts are also excluded*

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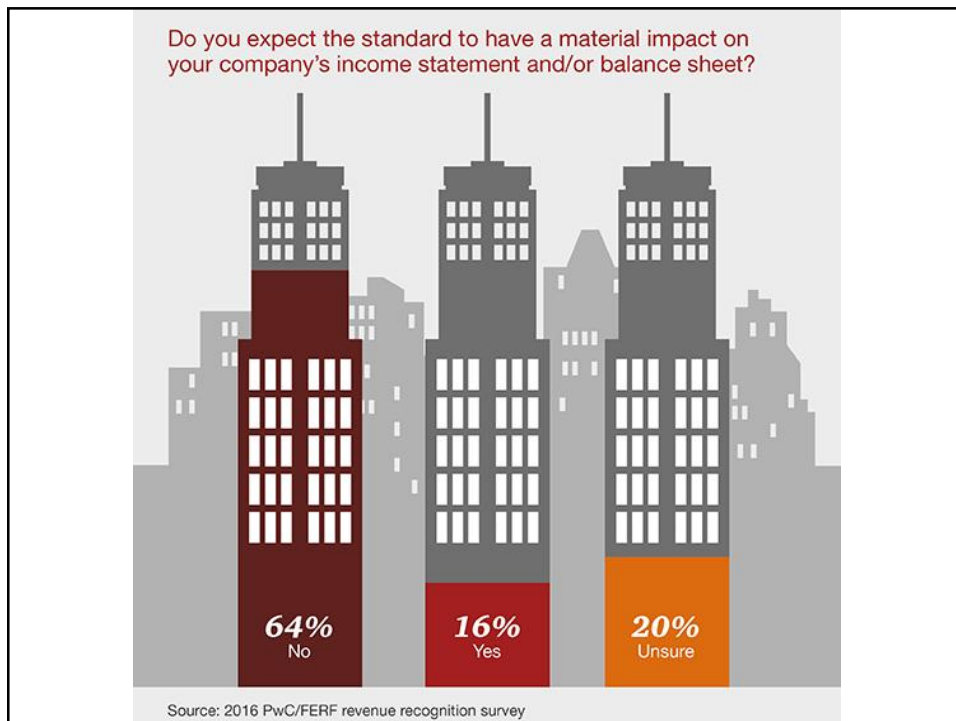
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## IMPLEMENTATION CONCERNS

- **Disproportionate cost**
- **Changes to policies and processes**
- **Additional disclosures beyond what has been typically provided**

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## WARNING SIGNS

- **Multiple deliverables**
- **Variable pricing (contingent amounts, discounts, tiered pricing levels, etc.)**
- **Services provided over time (e.g. projects)**
- **Deposits or other amounts received in advance**

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## CURRENT REVENUE RECOGNITION MODEL

- **Combination of broad principles with transaction-specific and industry-specific rules**
- **Resulted in inconsistencies for similar transactions**
- **Complex due to numerous pronouncements**
- **Gaps in the guidance still remained**

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## RECOGNITION PRINCIPLES

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- **OLD:** Revenue is earned when:
  - *Persuasive evidence of a contract exists*
  - *Delivery has occurred or services have been rendered*
  - *The seller's price to the buyer is fixed or determinable*
  - *Collectability is reasonably assured*
- **NEW:** 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 be entitled to receive in exchange for those goods or services.

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## FIVE-STEP PROCESS

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- **New guidance analyzes customer contracts as follows:**
  - *Identify the contract with a customer*
  - *Identify the performance obligations in the contract*
  - *Determine the transaction price*
  - *Allocate the transaction price to the performance obligations*
  - *Recognize revenue when the obligations are satisfied*

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## INDUSTRY IMPLEMENTATION TASK FORCES

- Sixteen AICPA industry task forces – including **Non-Profits**
- Address industry-specific issues related to new guidance and develop illustrative examples
- Incorporated into an Accounting Guide on Revenue Recognition
- <http://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/Pages/default.aspx>

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## IDENTIFYING CONTRACTS

- **Contracts exist when all of the following hold true:**
  - *Must have commercial substance (impact cash flows)*
  - *All parties approve it and are committed to performance*
  - *Each party has rights regarding the transfer of goods/services*
  - *The payment terms can be identified*
  - *Collection of consideration is probable (ability and intent)*

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## IDENTIFYING CONTRACTS

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- **Contracts create enforceable rights and obligations between two or more parties**
- **They can be written, oral, or implied by an entity's customary business practices**

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## CONTRACTS – NFP CONSIDERATIONS

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- **NFPs must still first evaluate whether an agreement is a contract (exchange transaction) or a contribution**
  - *This guidance does not apply to contributions*
  - *Government contracts may or may not be exchange transactions depending on the terms of the agreement.*
- **Have the contracts been formalized?**
- **Significant collectability issues may impact recognition**

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## IDENTIFYING PERFORMANCE OBLIGATIONS

- **A performance obligation is a promise to transfer either a:**
  - *Good or service that is distinct, or*
  - *A distinct series of goods or services that are essentially the same and have the same pattern of transfer to the customer*
- **Distinct – the customer can benefit from the good or service on its own and can be delivered separately by the vendor**

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## IDENTIFYING PERFORMANCE OBLIGATIONS

- **Performance obligations identify how the contract value is allocated and the timing of recognition**
- **A contract with only one performance obligation or series of obligations will have a simpler recognition method and may be consistent with the current approach**

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## PERFORMANCE OBLIGATIONS – NFP CONSIDERATIONS

- **Multiple deliverables**
  - *Different types of services*
  - *Access to goods or other resources (publications, facilities, intellectual property)*

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## DETERMINING THE TRANSACTION PRICE

- **The transaction price represents the amount of consideration the entity expects to be entitled to from the customer (not factoring in credit risk)**
- **Key area for many industries due to the variety of pricing considerations**
  - *Discounts, refunds, credits, etc.*
  - *Fixed and variable components*
  - *Contingent consideration*

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## DETERMINING THE TRANSACTION PRICE

- **Credits or other consideration to the customer should be netted against the transaction price (revenue) rather than being charged to expense**
  - *Consistent with current treatment for revenue reductions (e.g. agreed-upon medical reimbursement rates)*
  - *Different from current treatment for expense items such as warranties and certain rebate programs*

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## TRANSACTION PRICE – NFP CONSIDERATIONS

- **For NFPs, transaction price will often be fixed in total or by unit of service**
- **If there is variable pricing, the entity must estimate the amount expected to be earned at the beginning of the contract**
  - *Multiple techniques for computing estimated variable consideration*
  - *Also considers probability of outcomes and risk of reversal*

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## ALLOCATION OF TRANSACTION PRICE

- **Only applies if there are multiple deliverables**
- **The price should be allocated in proportion to the standalone selling price of each performance obligation**
  - *May require estimation using various methods if a standalone selling price is not available*
  - *In some cases, a residual value method is permitted.*

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## ALLOCATION CONSIDERATIONS – CONTRIBUTIONS

- **New guidance reaffirms the existing guidance in place for separating the contribution portion of a transaction from the exchange portion**
  - *Purchase of an event ticket or event sponsorship*
  - *Certain membership dues*
- **Should first identify the fair value of the exchange, with any residual amount reported as a contribution**

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## RECOGNIZING REVENUE

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- Revenue is recognized when (or as) each performance obligation is satisfied
- Based on the customer's ability to control the use of, and receive the benefits from, the goods or services
- Must determine at the inception of the contract whether control is achieved over time or at a point in time

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## RECOGNIZING REVENUE

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- An entity satisfies a performance obligation over time, if
  - *The customer simultaneously receives and consumes the benefit as the entity performs the task, or*
  - *The performance creates or enhances an asset that the customer controls as the asset is created or enhanced, or*
  - *The entity's performance does not create an asset with alternative use to the entity and the entity is entitled to payment for performance to date*

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## NFP INDUSTRY TASK FORCE TOPICS

- **Exclude contributions from scope of guidance**
- **Process for bifurcating transactions that are in part exchanges and in part contributions**
- **Specific guidance on tuition and housing transactions**
- **Guidance on subscriptions and membership dues (pending)**

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## TUITION AND HOUSING – MULTIPLE OBLIGATIONS

- **Contracts may include multiple components**
  - *Tuition*
  - *Housing*
  - *Nonrefundable deposit*
- **May be a situation in which the overall transaction price needs to be allocated to separately valued performance obligations**

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## TUITION AND HOUSING – MULTIPLE OBLIGATIONS

- **Remember: performance obligations are separate (distinct) if**
  - *The customer can benefit from each service on its own*
  - *The goods or services are separately identifiable in the contract*
- **Do the services modify each other or are interdependent?**
- **Is the primary benefit to the customer the combined output?**

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## TUITION AND HOUSING - CONTRACTS

- **Multiple deliverables to customers may be structured through individual contracts. Combining such contracts is appropriate when:**
  - *The contracts are negotiated as a package with a single commercial objective*
  - *The amount of consideration in one contract depends on the price or performance of the other contract*
  - *The goods or services promised in the contracts are a single performance obligation*

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## TUITION AND HOUSING – TRANSACTION PRICE

- **May take a portfolio approach to applying the revenue recognition model, rather than assessing each individual contract**
- **Contracts must have similar characteristics**
- **May be easier to estimate variable pricing considerations or collectability over a pool of contracts**

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## TUITION AND HOUSING – ALLOCATION

- **Assuming distinct performance obligations, transaction price (net of any concessions) should be allocated based on standalone prices for the various goods and services**
  - *Tuition*
  - *Housing*
  - *Meals*
- **Standalone pricing may not be available for some services**
- **Price concessions may apply to only certain services**

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## CONCLUDING THOUGHTS – KEY IDENTIFIERS

- **Multiple deliverables**
- **Variable pricing (contingent amounts, discounts, tiered pricing levels, etc.)**
- **Services provided over time (e.g. projects)**
- **Deposits or other amounts received in advance**

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## CONCLUDING THOUGHTS – IMPLEMENTATION

- **Document revenue recognition policies**
  - *Should address process for assessing the five steps*
  - *Cover each type of revenue transaction*
  - *Include procedures for re-evaluating estimates and assumptions*
- **Consider whether changes in recognition can be automated within the accounting system**

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## CONCLUDING THOUGHTS – CONTRIBUTIONS

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- **Contributions are specifically excluded from the scope of the new revenue recognition guidance and continue to be a major risk area for improper accounting**
  - *Determination of an exchange transaction versus a contribution*
  - *Identifying the correct timing for recognition*
  - *Oftentimes large transactions (e.g. grants)*

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## CONCLUDING THOUGHTS

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- **Any questions about revenue recognition?**

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## BUDGETING CONSIDERATIONS & BEST PRACTICES

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## ROLE OF BUDGETING

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- **What role does budgeting play in an organization?**
  - *Effective financial management is an ongoing process that features a cycle of good management habits – an integral part of this is thoughtful budgeting and monitoring*
  - *How can your organization execute its mission without a plan?*
  - *Budgeting is a form of risk management and transparency*

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## ATTITUDES ABOUT BUDGETING

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- **Common reactions when budget time rolls around**
  - *Again! I don't have time for this...*
  - *I hate numbers!!*
  - *I've got this!*

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## BUDGETING – WHERE DO YOU START?

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- **So we need a budget for our organization...what now?**
  - *Who should be involved?*
  - *When should budgeting occur?*
  - *What information do we need to get started?*

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## **BUDGETING – WHO SHOULD BE INVOLVED?**

- **Engage those responsible for making operating/program decisions first**
  - *CFO/Controller/Accountant; Executive Director; HR*
- **Include those who need to adhere to the budget**
  - *Program Directors, Staff*
- **Let the staff make the “first pass”**
- **Determine level of board participation**

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## **BUDGETING – WHEN SHOULD IT OCCUR?**

- **Do not wait until year-end to budget**
- **Stick to a schedule or timeline annually**
- **Delegate to reduce stress**

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## BUDGETING – WHAT INFORMATION IS NEEDED?

- **History tells your story**
  - *Trends and expectations*
  - *Current year YTD comparison to budget*
  - *Forecast out to the end of the year*
- **What is our plan for the future?**
- **Not all budget figures are dollars and cents**

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## BUDGETING BEST PRACTICES

- **Where have we been and where are we going?**
- **Mission first**
- **Don't forget the capital**
- **What about the people?**
- **Where did all of our cash go?**

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## BUDGETING BEST PRACTICES

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- **Where have we been and where are we going?**
  - *Basing your budget on prior experience*
  - *Start with your income*
  - *Risks of income concentration or volatility*
  - *Identify variables and future growth (or risks of contraction)*

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## BUDGETING BEST PRACTICES

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- **Mission first**
  - *Does this budget support our mission?*
  - *Where do we see ourselves in 5 years or 10 years?*
  - *Long-term strategic planning*

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## BUDGETING BEST PRACTICES

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- **Don't forget the capital**
  - *Not all budgeting is about period costs and expenses*
  - *What do we need to plan for to support our operations?*
  - *Capital campaigns*
  - *Board designations for future growth or reserves*

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## BUDGETING BEST PRACTICES

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- **What about the people?**
  - *Budgeting for personnel costs can be directly related to employee loyalty and satisfaction*
  - *Your employees are vital to your mission*
  - *Budget or performance-based compensation arrangements (pros and cons)*
  - *Don't forget the benefits*

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## BUDGETING BEST PRACTICES

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- **Where did all of our cash go?**
  - *Not all budget line items relate to cash*
  - *Timing of income and expense plays an important role*
  - *Consider restrictions and long term grants/donations*

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## COMMON BUDGETING PITFALLS

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- **Inflating revenue accounts to cover budgeting pitfalls (examples – grants/contributions)**
- **Not understanding the impact of investment gains/losses and income (including unrestricted)**
- **Understanding the impact (or lack thereof ) of depreciation**

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## WE HAVE OUR BUDGET... NOW WHAT?

- **Monitor, analyze, refine, repeat...**
- **Informed employees result in accountability**
- **Be prepared for the unexpected**
- **Ask questions and challenge the budget**
- **Align budget with your internal reporting or general ledger format**

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## REVIEW AND ANALYSIS

- **Should be done regularly (possibly in conjunction with board meetings)**
- **Prepare budget v actual reports for staff and board**
- **Create an action plan to address budget shortfalls**
- **Revise the budget if necessary**

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## LOGISTICS

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- **Evaluate the budget features of your software or use Excel**
- **Present the budget to the board in a manner that is consistent with the other financial information they receive**
- **Detailed program budgets should be collapsed for outside or board reporting**
- **Consider formatting (example – while colors are nice, they may not translate when copied)**

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## RESOURCES

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- [www.nonprofitaccountingbasics.org](http://www.nonprofitaccountingbasics.org)
- [www.councilofnonprofits.org](http://www.councilofnonprofits.org)
- [www.nonprofithub.org](http://www.nonprofithub.org)
- [www.wallacefoundation.org](http://www.wallacefoundation.org)

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QUESTIONS?

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