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Nonprofit Financial Reporting: Implementing the New Standard

Presented by Dave Ljung, President and CEO, Bobbie Hales, Director of the Firm's Nonprofit and Association Services and our management team

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Financial Statements of Not-for-Profit Entities

- ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*
  - Issued in August 2016

- Biggest change in NFP financial reporting since FASB Statements 116 and 117 issued in 1993

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Financial Statements of Not-for-Profit Entities

- FASB believes this new standard will make reporting:
  - More comparable
  - Easier to understand
  - Help NFPs better tell their story
  - More useful – information on liquidity, financial performance, nature of expenses

Financial Statements of Not-for-Profit Entities

- Based on feedback received, the FASB delayed certain portions of their initial proposed changes

- Changes now split into two phases

Financial Statements of Not-for-Profit Entities

- Phase 1 (ASU 2016-14) – effective for fiscal years beginning after 12/15/2017 (e.g. December 31, 2018 or June 30, 2019)

- Phase 2 – Date for finalization not set
  - Changes could be significantly modified or removed entirely
  - FASB may coordinate Phase 2 to coincide with its other project – Financial Performance Reporting for Business Entities

Key Changes (ASU 2016-14)

Net Assets:
- Reduced from 3 to 2 classes
- Disclosure of board designations
- Underwater endowment classification and disclosure changes
- Expiration of capital restrictions

Liquidity/Availability
- Quantitative disclosures about availability
- Qualitative disclosures about liquidity

Expenses:
- Must present by nature and function in one place
- Enhanced disclosures for allocation methods

Investment Return:
- Netting investment expenses required
- Requirement to report components of investment return components removed

Operating Measures:
- Enhanced disclosures, primarily relating to board appropriations, designations, and transfers

Statement of Cash Flows:
- Eliminates reconciliation of changes in net assets when the direct method is chosen

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Net Asset Classifications

Current Rules	ASU 2016-14
1. Unrestricted	1. Without Donor Restrictions
2. Temporarily Restricted 3. Permanently Restricted	2. With Donor Restrictions

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Net Asset Classifications

Current Rules

ABC FOUNDATION	
STATEMENT OF FINANCIAL POSITION JUNE 30, 2019	
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 3,679,638
Accounts receivable	2,095,990
Contributions receivable	855,017
Prepaid expenses and other assets	94,579
Total current assets	6,725,224
NONCURRENT ASSETS:	
Investments	41,818,675
Property and equipment, net	129,932
Total noncurrent assets	41,948,607
TOTAL ASSETS	$48,673,831
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES:	
Accounts payable	$ 1,514,905
Deferred revenue	687,081
Total current liabilities	2,201,986
NET ASSETS:	
Unrestricted	17,663,653
Temporarily restricted	8,808,192
Permanently restricted	20,000,000
Total net assets	46,471,845
TOTAL LIABILITIES AND NET ASSETS	$48,673,831

ASU 2016-14

ABC FOUNDATION	
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With donor restrictions	28,808,192
Total net assets	46,471,845
TOTAL LIABILITIES AND NET ASSETS	$48,673,831

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Net Asset Classifications

NFPs have option to disaggregate further

NET ASSETS:	
Without donor restrictions	17,663,653
With donor restrictions	28,808,192
Total net assets	46,471,845
TOTAL LIABILITIES AND NET ASSETS	$48,673,831

Minimum Requirements

vs.

Disaggregated Option

NET ASSETS:	
Without donor restrictions:	
Board designated operating reserve	2,000,000
Board designated endowment	8,000,000
Undesignated	7,663,653
Total	17,663,653
With donor restrictions:	
Perpetual in nature	20,000,000
Purpose restricted	6,808,192
Time-restricted only, for periods after 2019	2,000,000
Total	28,808,192
Total net assets	46,471,845
TOTAL LIABILITIES AND NET ASSETS	$48,673,831

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Net Asset Classifications

- Detail of donor-imposed restrictions still needs to be disclosed in notes if not on face of statement

Restricted for:

- Particular operating activities
- Investment for a specified term
- Use in a future period
- Acquisition of long-lived asset
- Assets donated to provide a permanent source of income

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Example statement of activities from the ASU

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

Changes in net assets without donor restrictions:	
Revenues and gains:	
Contributions	$ 8,640
Fees	5,200
Investment return, net	6,650
Gain on sale of equipment	200
Other	150
Total revenues and gains without donor restrictions	20,840
Net assets released from restrictions (Note D):	
Satisfaction of program restrictions	8,990
Satisfaction of equipment acquisition restrictions	1,500
Expiration of time restrictions	1,250
Appropriation from donor endowment and subsequent satisfaction of any related donor restrictions	7,500
Total net assets released from restrictions	19,240
Total revenues, gains, and other support without donor restrictions	40,080
Expenses and losses:	
Salaries and benefits	15,115
Grants to other organizations	4,750
Supplies and travel	3,155
Services and professional fees	2,840
Office and occupancy	2,528
Depreciation	3,200
Interest	382
Total expenses (Note F)	31,970
Fire loss on building	80
Total expenses and losses	32,050
Increase in net assets without donor restrictions	8,030
Changes in net assets with donor restrictions:	
Contributions	8,390
Investment return, net	18,300
Actuarial loss on annuity trust obligations	(30)
Net assets released from restrictions (Note D)	(19,240)
Increase in net assets with donor restrictions	7,420
Increase in total net assets	15,450
Net assets at beginning of year	270,640
Net assets at end of year	$ 286,090

Note: See paragraph 958-205-55-21 for the notes to financial statements.

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Example 2 statement of activities from the ASU

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues, gains, and other support:			
Contributions	$ 8,640	$ 8,390	$ 17,030
Fees	5,200		5,200
Investment return, net	6,650	18,300	24,950
Gain on sale of equipment	200		200
Other	150		150
Net assets released from restrictions (Note D):			
Satisfaction of program restrictions	8,990	(8,990)	
Satisfaction of equipment acquisition restrictions	1,500	(1,500)	
Expiration of time restrictions	1,250	(1,250)	
Appropriation from donor endowment and subsequent satisfaction of any related donor restrictions	7,500	(7,500)	
Total net assets released from restrictions	19,240	(19,240)	-
Total revenues, gains, and other support	40,080	7,450	47,530
Expenses and losses:			
Program A	13,296		13,296
Program B	8,649		8,649
Program C	5,837		5,837
Management and general	2,038		2,038
Fundraising	2,150		2,150
Total expenses (Note F)	31,970		31,970
Fire loss on building	80		80
Actuarial loss on annuity trust obligations		30	30
Total expenses and losses	32,050	30	32,080
Change in net assets	8,030	7,420	15,450
Net assets at beginning of year	84,570	186,070	270,640
Net assets at end of year	$ 92,600	$ 193,490	$ 286,090

Note: See paragraph 958-205-55-21 for the notes to financial statements.

Net Asset Classifications

- ASU example endowment disclosure – showing break-out of components

200Y

Endowment Net Asset Composition by Type of Fund as of June 30, 200Y

	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	$ 7,084	$ -	$ 7,084
Donor-restricted endowment funds:			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	97,759	97,759
Accumulated investment gains	-	35,201	35,201
Term endowment	-	4,388	4,388
Total funds	$ 7,084	$ 137,348	$ 144,432

Net Asset Classifications

- ASU example endowment disclosure – still required to show changes in endowments

	Donor-Restricted Endowment Funds	Board-Designated Endowment Funds	Total
Investment return, net[(a)]	372	10	382
Contributions to donor-restricted endowment fund	2,000	-	2,000
Amounts appropriated for expenditure[(a)]	(7,077)	(373)	(7,450)
Transfer to create board-designated endowment funds	-	500	500
Total change in endowment funds	$ (4,705)	$ 137	$ (4,568)

(a) Included within investment return, net is $125 of 200Y net depreciation that occurred in recent donor-restricted endowment funds, causing the fair value of those funds to be less than the original gift amount. In addition, so as not to suspend certain programs, NFP B's Board deemed it prudent to continue to appropriate $75 to those programs.

Board Designations

Current disclosure requirements

- Board designated endowments required
- Other Board designations <u>optional</u>

ASU 2016-14 disclosure requirements

- Board designated endowment disclosures required – no change
- Other Board designations <u>required</u> – new requirement

Board Designations

- The nature and amount must be disclosed
  - On the financials or in footnotes
- Other items to consider
  - The board can delegate designation decisions to management
  - A NFP that chooses to designate should create policies on their creation, spend down, and releasing designation

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Board Designations

- Example footnote disclosure from AICPA

May present as table -

Net assets without donor restrictions:	
Board designated operating reserve	1,300
Board designated endowment	35,000
Undesignated	7,663
Total	43,963

Or in narrative format -

Note 13 - Net Assets Without Donor Restrictions

The Board of Directors of XYZ Organization has several standing board policies that affect the presentation of board designations on net assets. Bequests without donor restrictions are designated for long-term investment (quasi-endowment). The quasi-endowment fund balance totaled $35,000 at December 31, 20XX. Additionally, the Board of Directors has established an operating reserve with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need. The operating reserve balance totaled $1,300 at December 31, 20XX.

Underwater Endowments

Current Rules:

- Included with unrestricted net assets

ASU 2016-14:

- Included in net assets with donor restrictions

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Underwater Endowments

ASU 2016-14 Enhanced Disclosures

- Underwater endowment disclosures:
  a) The fair value of the underwater endowment funds
  b) The original endowment gift amount or level required by donor stipulations or by law that extends donor restrictions
  c) The aggregate of the amount of the deficiencies of the underwater endowment funds [(a) less (b)]
  d) Spending policy disclosure will include policy to either reduce expenditure or not spend from underwater endowment funds, and if this policy was followed

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Underwater Endowments

Example disclosure:

Underwater Endowments

From time to time, the fair value associated with individual donor restricted endowment funds may fall below the amount required to be maintained by donors or by law. At December 31, 2018, funds with original gift values of $12,000, fair values of $9,739, and deficiencies of $2,261 were reported in net assets with donor restrictions. The Organization has interpreted UPMIFA to permit spending from underwater endowments in accordance with prudent measures required under law. As required by the Organization’s endowment policies, spending from underwater endowments was restricted to three percent of the endowment’s fiscal year beginning balance and will remain as such until the original gift value is restored through subsequent increases in fair value.

Expiration of Capital Restrictions

Current rules for contributions to purchase or construct long-lived assets

- Allowed for the choice of:
  1. Releasing restriction when asset placed in service
  2. Releasing restriction over life of asset (matches depreciation expense)

ASU 2016-14 rules

- Require release of restriction when placed in service

Expiration of Capital Restrictions

ASU 2016-14 rules for contributions to purchase or construct long-lived assets

- Example: NFP A receives contributions of $1M in 2018 for purchase of new facility. In 2019, the building was purchased for $1.2M.
  - 2018: Record debit cash $1M, credit contributions with purpose restriction $1M
  - 2019:
    1. Credit cash $1.2M, debit building/land $1.2M
    2. Debit net assets released from restriction $1M to reduce net assets with purpose restrictions and credit net assets released from restrictions $1M to reflect increase in net assets without donor restrictions

Implementation Checklist
Net Assets

- ❑ Determine whether you will need to adjust your GL, Excel spreadsheet, or other tracking mechanism to accommodate the new terminology and presentation

- ❑ Determine the appropriate level of disaggregation of net assets you wish to present among: net assets without donor restrictions; those with donor restrictions that will be satisfied over time and/or by expenditure for a particular purpose; and those that will be maintained in perpetuity

- ❑ Decide the degree of disaggregation you wish to present on the face of the statement of financial position vs in the notes

Implementation Checklist Board Designations

- Assemble information about the amounts and purposes of board designation if not already disclosed
- Formalize policies for the use, creation and requirements to un-designate if these do not already exists
- Draft language to include in the liquidity and availability note pertaining to the self-imposed limitations on board-designated funds, and the conditions under which such funds would be made available to meet expenditure needs

Implementation Checklist Endowments

- Recast your endowment note to conform to the new two-net-asset categories presentation
- For underwater endowments, determine:
  - The fair value of underwater funds
  - The original gift amount or level required by donor stipulations or law that extends donor restrictions
  - The aggregate amount of the deficiencies of each underwater fund
- Reclass underwater endowment funds previously included in unrestricted net assets to net assets with donor restrictions

Implementation Checklist Endowments cont'd

- Make sure endowment investment return includes investment expenses *
- Remember components of investment return is not required to be disclosed for endowments *
- Determine if direct internal investment expenses have been incurred and thus included in investment return *

*Covered in expense section

Liquidity and Availability of Resources

- NFPs required to provide:
  - **Qualitative** information on how a NFP manages its liquid available resources and its liquidity risk
    - Disclosed in the notes
  - **Quantitative** information that communicates the availability of a NFP's financial assets at the balance sheet date to meet cash needs for the general expenditures within one year (on the face and/or in the notes)

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Liquidity and Availability of Resources

- Examples of financial assets:
  - Cash
  - Accounts receivable
  - Pledges receivable
  - Notes receivable
  - Investments
- Examples of nonfinancial assets:
  - Prepaid expenses
  - Inventory
  - Property and equipment
  - Intangible assets

Liquidity and Availability of Resources

- When determining availability consider factors such as:
  - Nature of the asset
  - External limits imposed by donors, laws, and contracts
  - Internal limits imposed by the board

Liquidity and Availability of Resources

- Examples to follow
  - There are many ways to satisfy this requirement
    - All narrative
    - Combined use of tables and narrative
    - Sample options for showing financial assets available within one year:
      - List all current financial assets
      - Start with total current assets, then subtract non-applicable items
      - List all financial assets, then subtract non-applicable items
      - Others (be creative)

Liquidity and Availability of Resources - Implementation

ASU Example 1 - combined qualitative and quantitative disclosure:

Sample financials – example on following page

Not-for-Profit Entity A
Statement of Financial Position
June 30, 20X1
(in thousands)

		20X1
Assets:		
Cash	$	75,000
Contributions receivable		20,000
Prepaid expenses		5,000
Short-term investments		300,000
Total assets	$	400,000
Liabilities:		
Accounts payable	$	80,000
Total liabilities		80,000
Net assets:		
Without donor restrictions	$	300,000
With donor restrictions		20,000
Total net assets		320,000
Total liabilities and net assets	$	400,000.00

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Liquidity and Availability of Resources - Implementation

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Quantitative

NFP A has $395,000 of financial assets available within 1 year of the balance sheet date to meet cash needs for general expenditure consisting of cash of $75,000, contributions receivable of $20,000, and short-term investments of $300,000. None of the financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the balance sheet date. The contributions receivable are subject to implied time restrictions but are expected to be collected within one year. NFP A has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately $275,000.

Qualitative

NFP A has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, NFP A invests cash in excess of daily requirements in various short-term investments, including certificate of deposits and short-term treasury instruments. As more fully described in Note XX, NFP A also has committed lines of credit in the amount of $20,000, which it could draw upon in the event of an unanticipated liquidity need.

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Liquidity and Availability of Resources - Implementation

ASU Example 2:

NFP A's financial assets available within one year of the balance sheet date for general expenditure are as follows:

Cash and cash equivalents	$	4,575
Accounts and interest receivable		2,130
Contributions receivable		1,825
Short-term investments		1,400
Other investments appropriated for current use		10,804
	$	20,734

This option presents only financial assets that are available in next 12 months

NFP A's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. As described in Note Y, the quasi-endowment has a spending rate of 5 percent. $1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.

As part of NFP A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, NFP A invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of $20 million, which it could draw upon. Additionally, NFP A has a quasi-endowment of $33 million. Although NFP A does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, amounts from its quasi-endowment could be made available if necessary. However, both the quasi-endowment and donor-restricted endowments contain investments with lock-up provisions that would reduce the total investments that could be made available (see Note X for disclosures about investments)

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Liquidity and Availability of Resources - Implementation

ASU Example 3:

The following reflects Not-for-Profit Entity A's financial assets as of the balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date. Amounts not available include amounts set aside for long-term investing in the quasi-endowment that could be drawn upon if the governing board approves that action. However, amounts already appropriated from either the donor-restricted endowment or quasi-endowment for general expenditure within one year of the balance sheet date have not been subtracted as unavailable

Financial assets, at year-end	$ 234,410
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions	(174,700)
Investments held in annuity trust	(4,500)
Board designations:	
Quasi-endowment fund, primarily for long-term investing	(36,600)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	$ 5,370

This option presents all financial assets then subtracts those not available in next 12 months

Not-for-Profit Entity A is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, Not-for-Profit Entity A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of Not-for-Profit Entity A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, Not-for-Profit Entity A invests cash in excess of daily requirements in short-term investments. Occasionally, the board designates a portion of any operating surplus to its liquidity reserve, which was $1,300 as of June 30, 20X1. There is a fund established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, Not-for-Profit Entity A also could draw upon $10,000 of available lines of credit (as further discussed in Note XX) or its quasi-endowment fund.

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Liquidity and Availability of Resources - Implementation

Example from AICPA national NFP conference:

The Theater's working capital and cash flows have seasonal variations during the year attributable to the annual cash receipts for subscriptions and a concentration of contributions received near calendar year end. To manage liquidity the Theatre maintains a line of credit of $3 million with a bank that is drawn upon as needed during the year to manage cash flow and is then repaid in full by the end of the fiscal year. See Note Y for further description of this line.

The following reflects the Theater's financial assets as of the balance sheet date, reduced by amounts not available for general use within one year of the balance sheet date because of contractual or donor-imposed restrictions or internal designations. Amounts available include the Board-approved appropriation from the endowment fund for the following year as well as donor-restricted amounts that are available for general expenditure in the following year. Amounts not available include amounts set aside for operating and other reserves that could be drawn upon if the Board of Directors approves that action.

	2016	2015
Current assets, excluding non-financial assets	3,183,318	2,710,890
Add: endowment fund appropriation for following year	547,700	591,554
Subtract: cash restricted by lessor to specific uses	(942,941)	(823,430)
Subtract: donor restrictions for specific purposes	(250,000)	
Subtract: board-designated operating reserves and other	(225,129)	(299,011)
Financial assets available to meet cash needs for general expenditure within one year	$ 2,312,948	$ 2,180,003

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Implementation Checklist Liquidity/Availability

- Identify all financial assets
  - Identify any limitations on availability for expenditure in the next 12 months
  - Create a schedule detailing only those available in the next 12 months, or
  - Create a schedule of all financial assets with reductions indicated for those not available for expenditure in the next 12 months
- Consider developing a formal policy for managing the organization's liquidity needs

Implementation Checklist Liquidity/Availability cont'd

- Gather/consider the following in order to draft the note disclosure describing how the entity manages its liquid assets and liquidity needs:
  - How financial assets are managed/invested
  - Conditions for use of board designated net assets
  - Access to lines of credit or other financing
  - Seasonality of programs and activities
  - How the organization ensures financial assets received with restrictions by donors are available to meet those purposes
  - Any other factors to assist in understanding the organization's liquidity

Expense Reporting

- ASU 2016-14 requires reporting expenses by both nature and function in one place
- Current standards only require reporting expenses by function
  - Unless you are voluntary health and welfare organization, which are already required to present a statement of functional expenses
- Can be achieved on statements or in the notes
  - Choice of location - statement of functional expenses, statement of activities, or disclose in the notes

Expense Reporting

- What are functional and natural expenses?

  - ***Function*** – Program and supporting activities

    - **Program activities** - The activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists.

    - **Supporting activities** – all activities of a NFP other than program services (management and general, fundraising, membership development)

  - ***Natural classification*** – examples include salaries, rent, electricity, supplies, interest expense, depreciation, and professional fees

Example - expenses by both nature and function in the statement of activities

- Best suited for NFPs with one program only

EXPENSES:	
Grant activities:	
Grants	680,500
Personnel costs	506,374
Occupancy	120,510
Depreciation	35,266
Travel	12,581
Other	6,897
Total program services	1,362,128
Management and general:	
Personnel costs	129,593
Occupancy	30,128
Depreciation	8,819
Travel	1,563
Other	3,625
Total management and general	173,728
Total expenses	1,535,856

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Example - statement of functional expenses

- Separate statement or footnote

	Program Activities				Supporting Activities			
	A	B	C	Programs Subtotal	Management and General	Fund-Raising	Supporting Subtotal	Total Expenses
Salaries and benefits	$ 7,400	$ 3,900	$ 1,725	$ 13,025	$ 1,130	$ 960	$ 2,090	$ 15,115
Grants to other organizations	2,075	750	1,925	4,750				4,750
Supplies and travel	890	1,013	499	2,402	213	540	753	3,155
Services and professional fees	160	1,490	600	2,250	200	390	590	2,840
Office and occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,440	800	570	2,810	250	140	390	3,200
Interest	171	96	68	335	27	20	47	382
Total expenses	$ 13,296	$ 8,649	$ 5,837	$ 27,782	$ 2,038	$ 2,150	$ 4,188	$ 31,970

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Expense Reporting

ASU 2016-14 provides clarity on allocation requirements (not optional)

- Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities

- Certain costs benefit more than one function and, therefore, shall be allocated
  - Examples include information technology, executive director salary, depreciation, supplies, and rent

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Expense Reporting

Management and general costs not typically allocable to other functions

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than contributions and membership dues
- Administering government, foundation, and similar customer sponsored contracts, including billing and collecting fees and grant and contract financial reporting
- Disseminating information to inform the public of the NFP's stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report
- Employee benefits management and oversight (human resources)
- All other management and administration except for the direct conduct or direct supervision of program services, fundraising activities, or membership development activities

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Expense Reporting

- NFPs required to provide qualitative disclosures about methods used to allocate costs among program and support functions
  - Methods of allocation not specified
    - Common methods include:

Time spent allocation - used for personnel costs

Square footage - used for occupancy costs (rent, electricity, telecommunications), central support, supplies

Head count – used for occupancy, central support, supplies

Direct labor – used for occupancy, central support, supplies

Relative revenue - used for occupancy, central support, supplies

Stand alone costs (cost for each program alone divided by the combined costs of all programs incurring the costs) – used for occupancy, central support, supplies

Expense Reporting

ASU Example 1

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation and office and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits, which are allocated on the basis of time and effort studies.

ASU Example 2

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is allocated based on square footage, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

Implementation Checklist Expense Reporting

- Determine where/how to present all expenses by nature and function in one place (statement of activities, statement of functional expenses, or footnotes)
- Identify level of disaggregation
  - How many program service categories
  - If the organization receive contributions, supporting services should include a fundraising category
- Categorize expenses between those that can be directly charged vs. those that are allocable

Implementation Checklist Expense Reporting cont'd

- Develop/revisit formal allocation methodologies to be used to allocate expenses among programs and supporting services
- Draft note describing allocation methods
- Accumulate external and direct internal investment expenses to be reported net with investment return and excluded from program or supporting expenses

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Investment Return

- Net presentation now required
  - All external and direct internal investment management and custodial expenses netted against investment income
  - Investment expenses can no longer be shown as a natural expense category
  - The requirement to disclose the components of net investment return is no longer required for investments or endowments

No longer required

Investment income consists of the following for the year ended December 31, 2018:

Interest and dividends	$	906,725
Net realized and unrealized loss		(306,400)
Total	$	600,325

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Investment Return

- Internal expenses include the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return
  - Salaries, benefits, travel, and other costs associated with staff responsible for development and execution of investment strategy
  - Supervision, selecting and monitoring external managers
  - Excludes costs not associated with generating investment return, such as managing the use of endowment funds

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Operating Measures

Some nonprofits report an operating measure in the statement of activities (e.g. Income From Operations)

- Operating measure is optional under current rules and ASU 2016-14
- Current rules require disclosure of what's included/excluded if not apparent
- The new rules require this disclosure to include how the measure is effected by appropriations from board designated funds or similar transfers

Operating Measures

How to meet the requirements if your report an operating measure

- Option 1 – Define specifically what is including in the operating measure.
- Option 2 – Start with the change in net assets without donor restrictions and disclose what is not included

<u>Example</u>

Operating results in the statement of activities includes all transactions increasing or decreasing net assets without donor restrictions except those associated with long-term investments, changes in post retirement obligations, changes in the fair value of derivative instruments, and other infrequent gains and losses.

Statement of Cash Flows

- NFPs will continue to have the option of using the direct or indirect method
  - The requirement to report a reconciliation of the change in net assets to cash flow from operations has been eliminated when the direct method is chosen.

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Effective Dates/Early Adoption

- Effective Date: for fiscal years beginning after 12/15/2017

- Early adoption: Permitted, but must early adopt all provisions in phase 1

Transition Year

- Transition:
  - For year of adoption: apply <u>all</u> provisions, retroactive application
    - Will result in restatement of beginning balances for items such as:
      - Contributed long-lived assets with restrictions released over useful life
      - Underwater endowments

Transition Year

- Transition:
  - For comparative years presented: apply all provisions, except can choose not to present:
    - Analysis of expenses by nature and function, and/or
    - Disclosures around liquidity and availability of resources (qualitative and quantitative information)

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What's Coming Next?

ASU 2014-09 *Revenue from Contracts with Customers*

- Effective for nonpublic entities for fiscal years beginning after 12/15/2018 (e.g. December 31, 2019 or June 30, 2020)
- Key Principles:
  - Change from rule based to principle based approach for recognizing revenue – 5 step recognition process
  - Recognize revenue when (or as) performance obligation is satisfied
    - Results in separate recognition of components of a contract or membership rather than evenly over contract or membership period
  - Enhanced disclosures on revenue recognition in footnotes

What's Coming Next?

- ***Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made***
  - In exposure draft stage – Issued 8/3/2017, comments due 11/1/2017 ****Subject to change****
  - Effective for nonpublic entities for fiscal years beginning after 12/15/2018 (e.g. December 31, 2019 or June 30, 2020)
  - Key Principles:
    - Clarifies what is a contribution vs. exchange transaction
      - Determination hinges on whether grantor is receiving commensurate value
        - Benefits received by general public does not mean commensurate value was received by grantor
      - Many government grants would be considered contributions

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What's Coming Next?

- ***Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made cont'd***
  - Key Principles cont'd:
    - Clarifies what constitutes a conditional contribution (conditional contributions are not recognized until conditions met)
      - A contribution that contains a ***barrier*** and ***right of return/right of release*** is considered conditional
        - Examples of barriers identified include: specified level of service, identified number of units of output, specific outcome, matching funds, limited discretion over how funds are spent
          - Requirement to spend in accordance with OMB cost principles would be a barrier
          - Requirement to spend in accordance with a general budget outlined in a grant agreement would ***not*** be a barrier

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What's Coming Next?

ASU 2016-02 *Leases*

- Effective for nonpublic entities for fiscal years beginning after 12/15/2019 (e.g. December 31, 2020 or June 30, 2021)
- Key Principles:
  - Most operating leases will be accounted for in a similar manner to traditional capital leases
  - Most facility leases and a significant portion of equipment leases are operating leases
    - Current operating lease accounting: expense evenly over lease period
    - ASU 2016-02: Lessee recognizes liability for future lease payment obligations and a right-of-use asset on the balance sheet

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Any Questions?

Thank you for joining us today!

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