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Behind the Curtain: Upcoming Changes to Nonprofit Accounting Standards

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*, was issued in August 2016

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

Financial Statements of Not-for-Profit Entities

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

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Financial Statements of Not-for-Profit Entities

- Based on feedback received, the FASB delayed certain portions of these 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

Phase 1 Key Changes

- Net Assets
- Cash Flows
- Liquidity and availability of resources
- Expenses
- Operating measures

Net Asset Changes

- Changes in Classification
- Disclosure of Board Designated Net Assets
- Underwater Endowment Disclosures
- Expiration of Capital Restrictions

Net Asset Classifications

Current GAAP – three classes

1. Unrestricted
2. Temporarily Restricted
3. Permanently Restricted

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Net Asset Classifications

Revised GAAP – Two classes

1. Without Donor Restrictions
   - Replaces unrestricted

2. With Donor Restrictions
   - Combines temporarily restricted and permanently restricted into one category

Net Asset Classifications

Current GAAP

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

Revised GAAP

ABC FOUNDATION	
STATEMENT OF FINANCIAL POSITION JUNE 30, 2019	
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 3,679,638
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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:	
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

Net Asset Classifications

NFPs may choose to disaggregate further

NET ASSETS:	
Without donor restrictions:	
Board designated	10,000,000
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

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

Board Designations

Current GAAP disclosure requirements

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

Revised GAAP disclosure requirements

- No change - Board designated endowments required
- Change - Other Board designations <u>required</u>*

information may be disclosed on face of statement or notes

Underwater Endowments

Current GAAP:

- Included with unrestricted net assets

- Disclose the aggregate deficiencies for all underwater endowment funds of the amount the donor-restricted endowment fair value is less than amount required by donor or law

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Underwater Endowments

Revised GAAP

- Included in net assets with donor restrictions
- 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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Expiration of Capital Restrictions

Current GAAP for contributed 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)

Revised GAAP for contributed long-lived assets

- Requires release of restriction when placed in service

Cash Flow Statement

- Allows the choice between either the **Direct Method** or the **Indirect Method**.

Decision is up to the NPO

- Indirect reconciliation is no longer required when presenting the Direct Method

Benefits of this Change

- NPOs now have the option to choose the cash flow method that provides the most benefit to the users of the financial statements
- Simplify the direct method (no longer required to show the indirect reconciliation)

Example of:
Direct Method
with
Indirect Reconciliation
(no longer required)

	20XX
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from contracts	$ 11,715,958
Cash received from public support	513,790
Cash received from other sources	2,000,000
Cash received from interest and dividends	(1,175,846)
Cash paid for services and goods	(12,241,955)
Cash paid for interest expense and fees	(5,761)
Net cash provided by operating activities	806,186
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of investments	(1,286,453)
Proceeds from sale and maturity of investments	1,578,277
Purchases of property and equipment	(533,980)
Net cash provided (used) by investing activities	(242,156)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Principal payments on debt	(24,438)
NET INCREASE IN CASH AND CASH EQUIVALENTS	539,592
CASH AND CASH EQUIVALENTS, Beginning of Year	6,859,793
CASH AND CASH EQUIVALENTS, End of Year	$ 7,399,385
CASH FLOWS FROM OPERATING ACTIVITIES:	
Increase in net assets	$ 474,794
Adjustments to reconcile to net cash provided by	
operating activities:	
Net realized and unrealized (gain) loss on investments	175,539
Depreciation	603,920
Loss on disposal of property and equipment	16,734
Changes in operating assets and liabilities:	
Contracts and other receivables	(773,706)
Prepaid expenses and other assets	53,408
Accounts payable	218,396
Accrued expenses and other liabilities	37,068
Deferred revenues	33
Net cash provided by operating activities	$ 806,186

Example of Indirect Method

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	20XX
CASH FLOWS FROM OPERATING ACTIVITIES:	
Increase in net assets	$ 162,782
Reconciliation to net cash provided by operating activities:	
Depreciation	152,017
Changes in:	
Accounts receivable	95,665
Contribution receivable	(59,200)
Inventories	(82,774)
Prepaid expenses	337,930
Accounts payable and accrued expenses	17,972
Net cash provided by operating activities	624,392
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(279,525)
Purchases of investments	(862,348)
Proceeds from sale of investments	720,717
Net cash used by investing activities	(421,156)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of long-term debt	675,035
Principal payments on long-term debt	(764,261)
Net cash used by financing activities	(89,226)
NET INCREASE IN CASH	114,010
CASH, Beginning of Year	367,118
CASH, End of Year	$ 481,128
SUPPLEMENTAL CASH FLOW INFORMATION:	
Interest paid	$ 85,142

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Example of Direct Method (No longer presenting the indirect reconciliation)

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	20XX
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from contracts	$ 10,540,112
Cash received from public support	513,790
Cash received from other sources	2,000,000
Cash paid for services and goods	(12,241,955)
Cash paid for interest expense and fees	(5,761)
Net cash provided by operating activities	806,186
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of investments	(1,286,453)
Proceeds from sale and maturity of investments	1,578,277
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CASH AND CASH EQUIVALENTS, Beginning of Year	6,859,793
CASH AND CASH EQUIVALENTS, End of Year	$ 7,399,385

Liquidity and Availability of Resources

- NPOs required to provide:
  - **Qualitative** information on how an NPO manages its liquid available resources and its liquidity risk
    - Disclosed in the notes
  - **Quantitative** information that communicates the availability of an NPOs 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

- Additional Information about liquidity shall be provided by any of the following:
  - Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to the nearness of their maturity and resulting use of cash
  - Classifying assets and liabilities as current and noncurrent
  - Disclosing in notes to financial statements any additional relevant information about the liquidity or maturity of assets and liabilities, including restrictions on the use of particular assets

Liquidity and Availability of Resources - Implementation

- Classified balance sheet is a good place to start for quantitative disclosures on availability as the most liquid assets and liabilities are sorted in descending order

- Quantitative disclosure could be provided in chart form (next slide)

Financial assets, year-end	$ 495,000
Less:	
Contractual or donor-imposed restrictions making financial assets unavailable for general expenditures within one year:	
Restricted by donor with time or purpose restrictions	(125,000)
Subject to appropriation and satisfaction of donor restrictions	(45,000)
Amounts set asset for liquid reserves	(21,000)
Financial assets available within one year to meet cash needs for general expenditures within one year	$ 304,500

Liquidity and Availability of Resources - Implementation

The following example of qualitative disclosure is provided by the new ASU:

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

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.

Liquidity and Availability of Resources - Implementation

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. 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 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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Expense Reporting

- Report expenses by both nature and function in one place

- Can be achieved on statements or in the notes
  - ***Function*** (currently required by GAAP)

  - ***Natural classification*** (currently only required for Health and Welfare organizations to present this information on the statement of functional expenses)

  - ***Analysis*** (disaggregate function by nature)
    - Choice of location - statement of functional expenses, statement of activities, or disclose in the notes

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

Expenses:	
Program services:	
Personnel costs	506,374
Grants	180,025
Occupancy	120,510
Depreciation	35,266
Travel	12,581
Other	6,897
Total program services	861,653
Management and general:	
Personnel costs	129,593
Occupancy	30,128
Depreciation	8,819
Travel	1,563
Fundraising expenses	3,625
Total management and general	173,728
Total expenses	1,035,381

Example of analysis of expenses by both nature and function in the notes to the financial statements

	Program Services			Supporting Services		
	Program A	Program B	Program C	General & Admin-istrative	Fundraising	Total
Salaries, benefits and taxes	$ 2,220,154	$ 541,819	$ 407,063	$ 409,950	$ 292,596	$ 3,871,582
Food	929,430	159,868	165,463	178,988	178,963	1,612,712
Depreciation	340,245	191,555	181,475	178,963	178,963	1,071,201
Occupancy and utilities	296,908	181,311	181,721	185,011	180,222	1,025,173
Printing and postage	178,382	174,299	159,131	181,591	315,480	1,008,883
Contributions	299,369	171,540	167,618	178,963	178,963	996,453
Professional services	171,309	171,632	160,125	283,106	214,963	1,001,135
Supplies	212,197	158,846	160,734	181,830	179,872	893,479
Interest and bank charges	211,061	160,811	160,190	178,963	178,963	889,988
Liability insurance	192,420	164,864	162,996	178,963	178,963	878,206
Autos	163,446	168,647	158,793	178,987	179,318	849,191
Miscellaneous	45,044	8,295	6,650	179,365	179,739	419,093
Total	$ 5,259,965	$ 2,253,487	$ 2,071,959	$ 2,494,680	$ 2,437,005	$ 14,517,096

Expense Reporting

- NPOs required to provide qualitative disclosures about methods used to allocate costs among program and support functions.
  - Adds transparency as to how costs are allocated between functions (programs) to the users of the financial statements
  - Example of disclosure:
    - 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

Reporting of Investment Expenses

- Investment expenses must now be netted against investment income and reported net in the statement of activities
- This change was made to eliminate the lack of comparability of investment expenses between NFPs as investment managers/brokers do not apply and report these expenses in a consistent manner
  - 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

Operating Measures

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

- Operating measure is optional under current GAAP and revised GAAP
- Current GAAP requires disclosure of what's included/excluded if not apparent
- Revised GAAP requires this disclosure to include how the measure is effected by appropriations from board designated funds or similar transfers

Phase 1 - 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

Phase 1 - Transition

- Transition:
  - For year of adoption: apply <u>all</u> provisions, retroactive application
  - 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)

Phase 2

- Requirement to report an intermediate operating measure based on:
  - Mission (business and charitable activity)
  - Availability (external donors and board actions)

- Presentation of internal transfers in discrete section of statement of activities
  - Internal transfers to/from operating activities

- Statement of Cash Flows realignment
  - Certain items would be classified differently to be consistent with operating measure

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Revenue Recognition

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Revenue Recognition

- Many Nonprofit executives are concerned with the changes posed by ASU 2014-09 *Revenue from Contracts with Customers*, (Topic 606)

- Concerns are primarily focused on which revenue streams the standard apply to, how to apply the new standard and when the new standard must be implemented

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Revenue Recognition

- There are five takeaways that Nonprofit Organizations should understand about the new standard:
  - I. The new standard is the result of a convergence effort between the FASB and the IASB (International Accounting Standards Board)
    - The standard represents an effort to remove a number of inconsistencies between the FASB and the IASB revenue recognition standards

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Revenue Recognition

II. The new standard develops a single, principle-based focus for revenue recognition

- The new standard focuses on the contract between the NFP and it customers for the provision of goods or services, and more specifically the rights and obligations of each party (a reciprocal transaction)

- Change from rule based to principle based in general means that revenue recognition will be based on the application of principles to specific circumstances or contract specifics

Revenue Recognition

III. Not all revenue sources are impacted

- The standard will impact almost every organization – although to differing degrees
- For instance, contribution and investment income will not be impacted

Revenue Recognition

- The ASU specifically excludes the following contracts from the scope of the new standard:
    - Leases
    - Insurance contracts
    - Receivables
    - Debt and equity securities
    - Liabilities and debt
    - Guarantees
    - Derivatives
    - Financial instruments
    - Transfer and services rights
    - Nonmonetary exchanges

Revenue Recognition

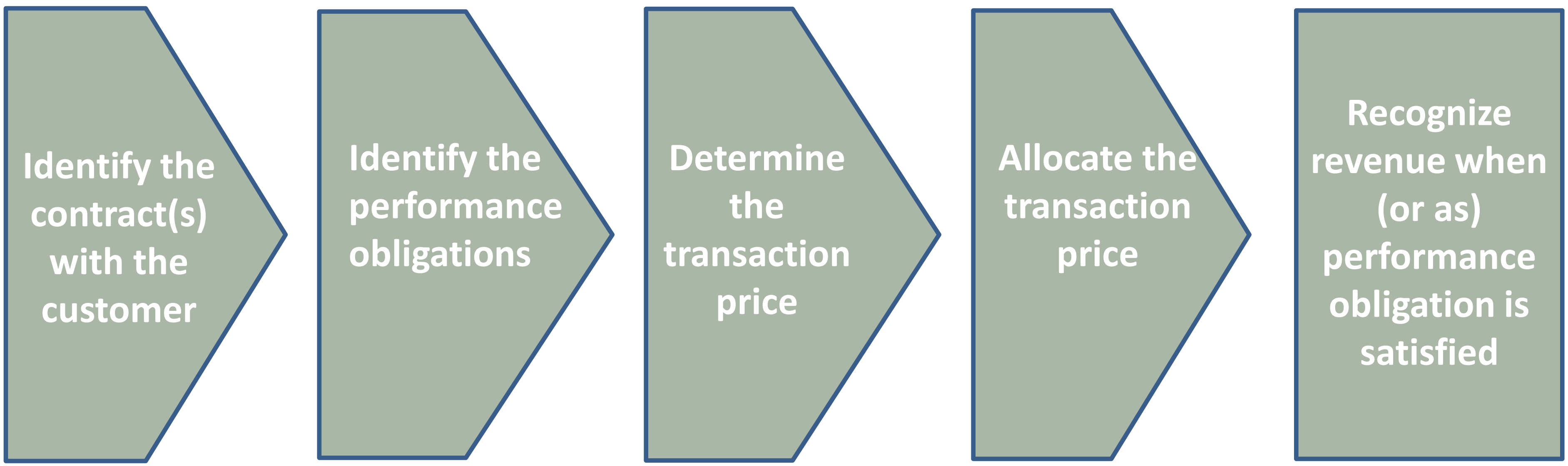
- However, a significant number of nonprofit revenue streams that would be considered contracts with customers may fall under the scope of the standard:
  - Memberships
  - Subscriptions
  - Products and service
  - Royalty agreements
  - Sponsorships
  - Conferences and seminars
  - Tuition
  - Advertising
  - Licensing
  - Federal and state grants and contracts

Revenue Recognition

- Certain revenue transactions will need to be evaluated to determine if they include a contribution element and a exchange transaction element to determine proper recognition

Revenue Recognition

IV. The new standard follows a 5-step recognition process



Revenue Recognition

- Examples
  - Membership dues with nominal benefits
  - Quarterly newsletter as a component of membership dues

Revenue Recognition

- Revenue Recognition of Grants and Contracts
  - Still under discussion
  - Contribution or Exchange Transaction?

Revenue Recognition

V. The effective dates are:

- Public entities – annual reporting periods after 12/15/17
- Nonpublic entities – annual reporting period after 12/15/18 (12/31/19 or 6/30/20)
- Early application is an option but no earlier than public company effective date

Revenue Recognition

- Next steps
  - Become familiar with the new standard, discuss the new standard with your accounting advisors and evaluate the impact on your organization
  - Evaluate all current revenue streams and determine if there are differences between current practices and the new standard

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Revenue Recognition

- Evaluate if the differences you identify should impact future contract modifications

- Identify information or data gaps between what is presently available and what will be needed for future required disclosures

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Revenue Recognition

- Nonprofits may want to consider what education process is needed for their boards

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