NOT FOR PROFIT UPDATE

Polling Question

Have you already implemented ASU 2016-14?

1. Yes
2. No

Top Issues for Not For Profit Entities

- ASU 2016 - 14
- ASU 2018 – 08
- Invitation to Comment
- Other new standards?
- FAQ's and more about functional expense allocations
- Auditing alternative investments

Presentation of Financial Statements of NFP ASU 2016-14

- Effective for fiscal years beginning after December 31, 2017
- First of a multipart project to improve the presentation of financial information of non profits
- Simplifies and improves guidance over classifications of net assets, disclosures and presentation of investment expenses

Presentation of Financial Statements of NFP ASU 2016-14

- For year of adoption apply all provisions
- For comparative years presented apply all provisions, except can chose not to present
  - ✓ Analysis of expenses by nature and function, and
  - ✓ Disclosures around liquidity and availability of resources

Presentation of Financial Statements of NFP ASU 2016-14

- Liquidity and Availability – qualitative and quantitative disclosures about liquidity
- Expenses – Requirement to report expenses by function, nature and analysis showing the relationship between function and nature
- Investment Return – Present investment return net of external and direct internal expenses, no disclosure of netted expenses
- Statement of Cash Flows – Continue to allow direct or indirect method for operating cash flows, indirect reconciliation no longer required for direct method
- Net Asset Classification – Updated net asset classification scheme to two classes, restricted and unrestricted

What was the real intent?

- Part 1 of a 2 part project to revisit and improve FASB 116 and FASB 117
- Emphasize board designations of funds and communicate better information to stakeholders
- Simplify reporting for endowments
- Provide better and more consistent information about program and administrative expenses
- Provide better information about investment expenses

Which NFP's are impacted?

- Charities
- Private and public foundations, colleges and universities
- Health care providers
- Cultural institutions, religious organizations and trade associates
- Diversity is part of the problem with NFP accounting

Liquidity Disclosure

- Might be the biggest challenge
- NFP’s required to provide both qualitative and quantitative information
- **Qualitative** – information on how a NFP manages its liquid available resources and its liquidity risk
- **Quantitative** - information that communicates the availability of an NFP’s financial assets at the balance sheet date to meet cash needs for general expenditures (on face of financials or in notes)

Implementing the Liquidity Disclosure

1. Identify all financial assets and any limitations on availability for expenditure in the next 12 months
2. Determine the format to present the required quantitative disclosure of liquidity information
   - Display gross amounts of financial assets then adjustments to arrive at "available for expenditure amounts", or
   - Display only the net amounts available for expenditure

Implementing the Liquidity Disclosure

3. Availability is affected by nature of asset, external limitations imposed by donors, contractual agreements and board designations
4. Determine whether presenting a classified statement of financial position could enhance or simplify the quantitative disclosure requirements
5. Develop a formal policy for managing the organization's liquidity needs to be discussed in the qualitative part of the note disclosure

Implementing the Liquidity Disclosure

6. Draft the note disclosure describing how the entity manages its liquid assets and liquidity needs including:
   - Conditions under which certain board-designated net assets may be undesignated
   - Access to the lines of credit or other financing sources
   - Any other information useful in understanding the entity's liquidity
7. Presenting a classified balance sheet might be the best way to accomplish

Presentation of Net Asset Classifications

- Now required to present on face of statement of financial position, the amount for each of two classes of net assets – those with donor restrictions and those without donor restrictions – instead of three
- Two classes
  - With donor/grantor-imposed restrictions, and time restrictions, either perpetual or temporary
  - Without donor/grantor-imposed restrictions, including board-designated

Presentation of Net Asset Classifications

- Retains current requirements to provide information about the nature and amounts of different types of donor restriction and/or governing board designations
- Changes to how **underwater endowments** are classified, i.e. the underwater amount is reported as a reduction to net assets with donor restrictions rather than a reduction to unrestricted net assets

What is an underwater endowment?

- Now defined in the Master Glossary

  Donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions

Net Assets

Current GAAP	Unrestricted	Temp. Restricted	Perm. Restricted
Revised GAAP	Without Donor Restrictions*	With Donor Restrictions*	
+ Disclosures	Amount, purpose, and type of board designations**	Nature and amount of donor restrictions	

*** NFPs may choose to disaggregate further**
**** New disclosure requirement**

Presentation of Net Asset Classifications - Disclosures

- Composition of net assets with donor/grantor restrictions
- Emphasis on how/when resources (net assets) can be used, ex. Specified purpose, specified time or perpetual endowment
- Qualitative and quantitative information about board designation

Statement of Functional Expenses

- Standard now requires all NFP's (not just voluntary health and welfare organizations) to provide information about operating expenses by both nature and function
- Can be on face of statement of activities, as a separate statement, or in notes to the financials
- Should be supplemented with enhanced disclosures about methods used to allocate costs among functions

Statement of Functional Expenses

- This process is one of the major differences that distinguishes an NFP from a for-profit entity. Most NFPs depend on contributions from the general public, so their donors rely on the information from their functional expense presentation to determine if their funds are being put to good use.

Statement of Functional Expenses

	Health Care Services					Support Services			
	Acute	Ambulatory	Physician	Post Acute	Health Plan	Research	MG&A	Fundraising	Total
Salaries and benefits	1,742.0	$ 321	$ 688	$ 459	$ 229	$ 229	$ 688	$ 229	$ 4,585
Purchased services	885	163	349	233	116	116	349	116	2,327
Supplies	428	79	169	113	56	56	169	56	1,126
Depreciation and amortization	214	39	85	56	28	28	85	28	563
Capitated purchased services	0	0	0	0	246	0	0	0	246
Rentals and leases	57	11	23	15	8	8	23	8	153
Interest	35	7	14	9	5	5	14	5	94
Insurance	5	1	2	1	1	1	2	1	14
Other	241	44	95	64	32	32	95	32	635
	$ 3,607	$ 665	$ 1,425	$ 950	$ 721	$ 475	$ 1,425	$ 475	$ 9,743

Statement of Functional Expenses

	Health Care Services			Support Services		
	North Region	**Central Region**	**South Region**	**MG&A**	**Fundraising**	**Total**
Salaries and benefits	$ 1,376	$ 917	$ 1,376	$ 688	$ 229	$ 4,586
Purchased services	699	466	699	349	116	2,329
Supplies	338	225	338	169	56	1,126
Depreciation and amortizatio	169	113	169	85	28	564
Capitated purchased services	74	49	74	37	12	246
Rentals and leases	45	30	45	23	8	151
Interest	28	19	28	14	5	94
Insurance	4	3	4	2	1	14
Other	191	127	191	95	32	636
	$ 2,924	$ 1,949	$ 2,924	$ 1,462	$ 487	$ 9,746

Presentation of Investment Expenses

- Required to present investment income net of external or direct internal investment expenses
- Disclosure of components of investment expense no longer required
- Should be a simplification that enhances comparability
- Internal expenses include the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return

Statement of Cash Flows

- NFP's may use either the direct or indirect method
- If the direct method is used, NFP's are no longer required to show the reconciliation of the change in net assets to cash flows from operating activities

Operating Cash Flows – Which is Better?

Direct Method

Cash flows from operating activities:	
Cash received from contributors	10,645
Cash received from service receipients	5,020
Interest and dividends received	8,570
Miscellaneous receipts	150
Cash paid to employees	(13,400)
Cash paid to suppliers	(5,658)
Interest paid	(382)
Grants paid	(5,175)
Net cash used by operating activities	(230)

Indirect Method

Cash flows from operating activities:	
Change in net assets	15,450
Adjustments to reconcile change in net assets to net cash	
Depreciation	3,200
Net gains on investments	(15,800)
Net gain on sale of equipment	(90)
Net change in operating assets and liabilities -	
Contributions receivable	(325)
Accounts receivable	(460)
Prepaid expenses and other assets	390
Accounts payable and accrued expenses	870
Grants payable	(425)
Contributions restricted for long-term investments	(3,040)
Net cash used by operating activities	(230)

User survey indicate a strong preference for the direct method – FASB is listening!

If using the indirect method, determine the potential usefulness of changing to the direct method

Presentation of Financial Statements of NFP – Phase 2

- Purpose is to reexamine:
  - Whether to require a measure of operations
  - Whether and how to measure operations
- Realignment of certain items in the statement of cash flow to correspond to an operating measure on the statement of activities
- Controversial and no expected time frame for completion

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Applies to all entities that receive or make contributions whether NFP or FP
- Excludes transfers of assets from government entities to for profit entities
- Applies to both contributions received and contributions made

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

Project Goal 1

- What is a reciprocal transaction?

Project Goal 2

- What is a conditional vs. unconditional grant or contribution
- May only be clarifications to current guidance

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Standard proved necessary due to the number of questions and general confusion as to the applicability of ASC 605, Revenue Recognition, to grants and contributions
- Project goal was to answer questions and provide improvements to old FASB 116

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Clarify how a not-for-profit entity determines whether a resource provider is participating in an exchange transaction or a contribution
- First ask whether each party receives commensurate value, if not, record as a contribution
- Societal benefit is not commensurate value

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Second step is if transaction is not reciprocal then are contributions are conditional or unconditional?
- The presence of conditions impacts the timing of revenue or expense recognition
- A conditional contribution must have (1) a barrier that must be overcome, <u>and</u> (2) a right of return or release of obligation to return the asset or cash

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Indicators that a barrier exists:
  a. NFP is required to achieve a measurable outcome
  b. NFP is required to overcome a barrier related to the primary purpose of the agreement,
  c. NFP has limited discretion over how the resources are spent

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

Reciprocal Transactions

- Account for under ASC 605
- Will be the default

Non Reciprocal Transactions

- Account for under ASC 985-720 NFP guidance

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Modify the simultaneous release option currently in GAAP, which allows a not-for-profit entity to recognize a restricted contribution directly in unrestricted net assets/net assets without donor restrictions if the restriction is met in the same period that revenue is recognized

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- The standard clarifies the distinction between donor-imposed conditions and donor-imposed restrictions on contributions and amends a recipient's ability to use what is known as the *simultaneous release accounting policy option*.

Clarifying the Accounting for Contributions Received and Contributions Made ASU 2018-08

- Although the ASU does not change the existing disclosure requirements for contribution transactions, many NFPs will need to add the required disclosures for conditional contributions for transactions that were previously accounted for as exchange transactions.

Invitation to Comment-

- Accounting Standards Update (ASU), *Intangibles—Goodwill and Other (Topic 350),Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958), Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*

Invitation to Comment-

- "FinREC supports the Board's intent to extend the scope of the accounting alternatives provided in Accounting Standards Updates (ASUs) 2014-02 and 2014-18 to not-for-profit entities (NFPs). We agree that the benefits of the current accounting for goodwill and identifiable intangible assets acquired in an acquisition by an NFP do not justify the related costs".

Accounting Standards Update No. 2019-03, *Not-for-Profit Entities (Topic 958): Updating the Definition of Collections*

- The standard requires the proceeds of sales from collection items to be used for the acquisition of new collection items, the direct care of existing collections, or both.
- Effective for years beginning after 12/15/2019
- Transition prospective

Accounting Standards Update No. 2019-03, *Not-for-Profit Entities (Topic 958): Updating the Definition of* Collections

Q&A Section 6140.27, *Not-for-Profit Entities*, Definition of *Direct Care* of Collection Items, provides nonauthoritative guidance explaining that the term “direct care” is not defined by FASB. The TQA discusses characteristics to consider when determining which costs are considered direct care of collection items.

Q&A for Non-Profits Conduit Bond Obligors

- What is a conduit bond obligor?
- While NFP's are specifically not included in the definition of a public business entity, NFP's with conduit bonds that meet certain characteristics are sometimes scoped into the same effective dates and disclosure requirements imposed on public entities
- Revenue recognition, leasing, credit losses

Q&A for Non-Profits Conduit Bond Obligors

- AICPA issued Technical Questions and Answers intended to address the definition of a public business entity which provides some additional guidance while not specifically being for the benefit of NFP's
- Within the TQA if the securities are sold on an OTC market the issuer may be a CBO
- Securities sold under private placement rules are not considered sold OTC
- See more at TQA 7100.03 and .04

Q&A for Non-Profits
Conduit Bond Obligors

- Per NFP Audit Guide

"FASB glossary has multiple definitions for the term public entity…it is necessary to determine whether the obligor's securities trade in public markets….if conduit bonds have been issued on behalf of an NFP in a competitive or negotiated offering they are deemed to trade in public markets; bonds issued in a private placement would not be deemed to trade in public markets"

Q&A for Non-Profits
Valuation of Gifts in Kind

- Are NFPs required to use fair value for gifts-in-kind?
- Yes: The definition of fair value is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”
- Currently applicable to contributions received by NFPs, including gifts-in-kind (GIK), and leads charities to use fair value, not the most conservative value

Q&A for Non-Profits
Valuation of Gifts in Kind

- Accounting results may vary based on facts and circumstances
- Management's documentation of its assessments and conclusions is key

Q&A for Non-Profits
Statement of Functional Expenses

- Do I need to include a Statement of Functional Expenses (SFE) in my report?
- Upon adoption, FASB ASU 2016-14, requires all NFPs to present their expenses by both function and nature in one place, which can be on the face of the Statement of Activities, in a separate statement (such as an SFE), or in the notes to the financial statements.

Q&A for Non-Profits Comparative Financials

- Do I need to provide comparative financial statements in my report?
- Not required but many present in total, rather than by net asset class
- On Statement of Activities may show only totals for revenues, expenses, etc. but not by net asset class
- On Statement of Functional Expenses may include only totals of functional expense categories for the prior year

Q&A for Non-Profits Comparative Financials

- GAAP allows NFPs to present comparative information for the prior year in total only and not by net asset class, but since this is not fully in compliance with GAAP, should label as "summarized financial information," to alert reader that prior-year information is not a full presentation in accordance with GAAP

Q&A for Non-Profits
Donated Services

- How do I value time donated by volunteers?
- Recognize contributed services if they (1) create or enhance nonfinancial assets, or (2) are specialized skills that would otherwise need to be purchased
- Contributed services recorded at fair value measured based on the fair value of the asset created or enhanced

Q&A for Non-Profits Expense Allocations

- What is the best way to allocate expenses by function?
- Varies from one NFP to another
- Many organizations use a time allocation study to allocate their expenses, while others determine the allocation of their usage of office space, for example, and apply that percentage to their indirect expenses

Q&A for Non-Profits Expense Allocations

- Most NFP's use a combination of these methods, or as determined most relevant
- The allocation method used should be appropriate to the types of expenses being allocated, for example allocation of utility expenses based on square footage rather than headcount.

Q&A for Non-Profits Lease Accounting

- Is accounting for leases going to change?
- Yes! new guidance for accounting for leases is effective for annual financial statements issued for years beginning after December 15, 2019.
- Lessees will be required to classify all leases as either operating or financing
- And will be required to recognize a liability for future lease payments and a right-of-use asset representing the entity's rights to the leased asset over the term of the lease

And…

- ASU 2017-10 Service Concession Arrangements effective 2019
- ASU 2016-01 Financial Instruments effective 2019
- ASU 2016-18 Statement of Cash Flows – Restricted Cash effective 2019
- ASU 2018-13 Changes to Disclosure Requirements for Fair Value Measurements effective 2020
- ASU 2016-13 Financial Instruments – Credit Losses effective 2021