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Navigating the Implementation of the New NPO Accounting Standards

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... Financial Reporting Changes Background

- Financial Accounting Standards Board (FASB) Not-for-Profit Advisory Committee (NAC)
- Studied areas for improving Generally Accepted Accounting Principles (GAAP) for NPOs
- ASU 2016-14 was issued August 18, 2016

... Learning Objectives

- Identify the most significant and complex challenges in adopting FASB's new financial statement standard.
- Determine policies, procedures, and systems that should be in place as a result of the standard.
- Identify implementation techniques that could assist in converting NPO's financial statements and footnotes to the new standard.

... Key Objectives of Standard

- Update, not overhaul, of the current model
- Provide better information to donors, grantors, creditors, and other users of the financial statements
- Improve on current net asset classification requirements
- Improve the presentation in the financial statements and disclosures about a NPOs liquidity, financial performance, expenses, and cash flows
- Enable NPOs to “better tell their financial story”

... Effective Dates and Transition

➤ Effective Date:

- Fiscal years beginning after 12/15/2017 (e.g. CY 2018 and FY 2018/2019)
- Interim financials the following year

➤ Transition:

- For year of adoption: apply all provisions
- 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

** unless already required to do so under current GAAP*

... #1 - Change in Net Asset Classes

- Address complexities with the current three classes of net assets
- Address misunderstandings and confusion around the term “unrestricted net assets”
- Address deficiencies in the information provided on how restrictions imposed by donors, laws, and governing boards affect an NFP’s liquidity and classes of net assets

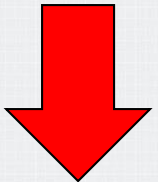
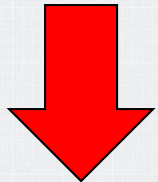
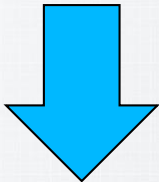
Two Net Asset Classes

Current
Presentation

Unrestricted

Temporarily
Restricted

Permanently
Restricted



New
Presentation

Without "Donor"
Restrictions

With "Donor"
Restrictions

... #1 - Change in Net Asset Classes

- Two classes
 - Without donor imposed restrictions
 - Includes board designated
 - With donor imposed restrictions
 - Includes perpetual and temporary
- Added disclosure requirements
 - Composition of net assets with donor restrictions
 - Emphasis on how/when net assets can be spent
 - Specified purpose
 - Specified time
 - Perpetual (endowment)
 - Quantitative information about board designations

Statement of Financial Position

Net assets:

Without donor restrictions	\$90,000
With donor restrictions	<u>110,000</u>

Total net assets	<u><u>\$200,000</u></u>
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Minimum presentation
required

Net assets:

Without donor restrictions -	
Undesignated	\$85,000
Designated by the Board for purpose	<u>5,000</u>
	90,000

With donor restrictions -	
Purpose restricted	55,000
Perpetual in nature	<u>55,000</u>
	110,000

Total net assets	<u><u>\$200,000</u></u>
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Alternative
disaggregation allowed

Statement of Activities - Example 1

	Without Donor Restrictions	With Donor Restrictions	Total
Revenue and other support:			
Contributions	\$ 8,600	\$ 8,400	\$ 17,000
Fees	5,200		5,200
Investment return, net	6,600	18,000	24,600
Other	300		300
Net assets released from restrictions	19,000	(19,000)	-
Total revenues and other support	39,700	7,400	47,100
Expenses:			
Program A	13,000		13,000
Program B	14,500		14,500
Management and general	2,000		2,000
Fundraising	2,000		2,000
Total Expenses	31,500	-	31,500
Change in net assets	8,200	7,400	15,600
Net assets at beginning of year	81,800	102,600	184,400
Net assets at end of year	\$ 90,000	\$ 110,000	\$ 200,000

Statement of Activities - Example 2

	Without Donor Restrictions	With Donor Restrictions				Total
		Program Restrictions	Endowment	Funds	Total	
Revenue and other support:						
Contributions	\$ 8,600	\$ 15,000	\$ 10,000	\$ 25,000	\$ 33,600	
Fees	5,200			-	5,200	
Investment return, net	6,600		(3,000)	(3,000)	3,600	
Net assets released from restrictions	19,000	(12,000)	(2,000)	(14,000)	5,000.00	
Total revenues and other support	39,400	3,000	5,000	\$ 8,000	47,400	
Expenses:						
Program A	13,000			-	13,000	
Program B	14,500			-	14,500	
Management and general	2,000			-	2,000	
Fundraising	2,000			-	2,000	
Total Expenses	31,500	-		-	31,500	
Change in net assets	8,200	3,000	11,000	14,000	22,200	
Net assets at beginning of year	81,800	52,000	44,000	96,000	177,800	
Net assets at end of year	\$ 90,000	\$ 55,000	\$ 55,000	\$ 110,000	\$ 200,000	

... Implementation – Net Assets

- Determine whether you will need to adjust your tracking mechanism (g/l, spreadsheet, etc.) to accommodate the new terminology and presentation.
- Determine whether in-service long-lived assets have implied time restrictions that will need to be released upon adoption of the ASU.
- Determine the appropriate presentation among net assets:
 - Without donor restrictions
 - With donor restrictions that will be satisfied over time and/or expenditure
 - Maintained in perpetuity
- Decide what to present on the face of the financials vs in the notes.

Footnote Disclosure With Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes or periods:

Subject to expenditure for specified purpose:

Program A activities:	
Purchase of equipment	\$ 5,500
Research	6,000
Educational seminars and publications	4,000
Program B activities:	
Disaster relief	2,000
Educational seminars and publications	10,000
Program C activities: general	2,000
Buildings and equipment	10,500
Annuity trust agreements for research	15,000
	<hr/> 55,000

Subject to NFP's spending policy and appropriation

Investment in perpetuity including amounts above original gift amount of \$40,000 the income from which is expendable to support:

Program A activities	20,000
Program B activities	12,000
Program C activities	23,000
	<hr/> 55,000

Total Net Assets with Donor Restrictions **\$ 110,000**

... Implementation – Board-designations

- Assemble information about the amounts and purposes of board designations of net assets without donor restrictions.
 - For presentation in notes and/or on the face of the SOFP
- Determine proper presentation of any board-designated endowment funds in the related endowment note.
- Draft language to include in the liquidity and available note.
 - Self-imposed limitations on board-designated funds
 - Conditions under which such funds would be made available to meet expenditure needs

... #2 - “Underwater” Endowments

- Updated FASB definition:
 - 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.
- Report entire balance of endowment fund “with donor restrictions” class of net assets.
- Enhanced disclosures related to underwater funds

... Underwater Endowments

- New disclosure requirements:
 - Interpretation of the NPO's ability to spend from underwater endowment funds
 - NPO's policy, and any actions taken during the period, concerning appropriation from underwater endowment funds
 - For each period presented – each of the following, in the aggregate for all underwater endowment funds:
 - 1) The fair value of the underwater endowment funds
 - 2) The original endowment gift amounts (or level required to be maintained by donor stipulations or by law that extends donor restrictions)
 - 3) The amount by which the original gift amounts exceeds the fair value

... Implementation – Endowments

- Change 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
- **Note:** Underwater portion of endowments now presented entirely in funds with donor restrictions

... #3 - Donations/Contributions Restricted for Purchase of Property & Equipment

- No longer allowed to imply a time restriction, except if explicit donor stipulations
- Placed-in-service approach
 - Reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset
 - Reclassify amounts from *net assets with donor restrictions* to *without donor restrictions* for long-lived assets placed in service as of the beginning of the period of adoption
- Eliminated the option to release the donor-imposed restriction over the estimated useful life of the asset
- Examples:
 - Donated vehicle
 - Capital campaign to build a new facility

... #4 - Reporting Expenses

- All NPOs, including Voluntary Health and Welfare Entities, must present an analysis of expenses by function and nature in one location. Options include:
 - Present a separate statement of functional expenses
 - Present a table in the notes
 - Incorporate into the statement of activities
- Include a description of the method(s) used to allocate costs among program and support functions
- The ASU includes improved and expanded guidance about management and general expenses

... Analysis of Expenses

Presentation in the notes or in a separate statement

	Program A	Program B	Program Subtotal	Management & General	Fund- Raising	Supporting Subtotal	Total Expenses
Salaries, benefits, and taxes	\$ 7,400	\$ 4,900	\$ 12,300	\$ 1,130	\$ 900	\$ 2,030	\$ 14,330
Grants to other organization	2,070	2,700	4,770				4,770
Supplies and travel	600	1,500	2,100	200	500	700	2,800
Services and professional fees	160	3,000	3,160	200	340	540	3,700
Office and occupancy	1,160	1,000	2,160	200	100	300	2,460
Depreciation	1,440	1,300	2,740	250	140	390	3,130
Interest	170	100	270	20	20	40	310
Total Expenses	<u>\$ 13,000</u>	<u>\$ 14,500</u>	<u>\$ 27,500</u>	<u>\$ 2,000</u>	<u>\$ 2,000</u>	<u>\$ 4,000</u>	<u>\$ 31,500</u>

... Analysis of Expenses

Presentation on the face of the Statement of Activities

Expenses:

Grant activities -

Grants	4,770
Salaries, benefits, and tax	12,300
Occupancy costs	2,160
Depreciation	2,740
Supplies	2,100
Other	3,430
	<u>27,500</u>

Management and general -

Salaries, benefits and taxes	1,130
Occupancy costs	200
Depreciation	250
Other	420
	<u>2,000</u>

Fundraising

Salaries, benefits and taxes	900
Other	1,100
	<u>2,000</u>

Total Expenses	<u>31,500</u>
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... Disclosures of Allocation Methods

Note X - Methods Used for Allocation of Expenses Among Program and Supporting Services

The financial statements report certain categories of expenses that are attributable to one or more program or supporting services of the Organization. Those expenses include depreciation, the Executive Director's office, communications department, and information technology department. Depreciation is allocated based on a square footage basis, the Executive Director's office is allocated based on a time and cost study of where efforts are made, certain costs of the communications department are allocated based on a cost study of where efforts are allocated based on the benefit received, and the information technology department is allocated based on a cost study of specific technology utilized.

... Functional Expenses Defined

➤ Program Services

- 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

- Supporting activities are all activities of an NPO other than program services. Generally, they include the following:
 - Management and general activities
 - Fundraising activities
 - Membership development activities

... Management and General Expenses

- 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 NPOs 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 of program services, fundraising activities, or membership development activities.

... Enhanced Guidance on M&G Allocation

- Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management & general activities
- Examples added:
 - IT – benefits various functions and generally would be allocated to program, fundraising, M&G
 - CEO – could be allocated to program, fundraising, M&G
 - CFO – could be allocated to M&G and investment expense
 - HR – generally would assign all to M&G
 - Grant Accounting and Reporting – program reports would be program (grant-related) but financial reports and related accounting would be M&G

... #5 - Investment Return

- Present on a net basis, with all external and direct internal investment management and custodial expenses netted against the return
- No longer required to report investment income components and related expenses separately
- 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, including allocable internal costs relating to oversight of external management firms
 - Excludes costs not associated with generating investment return

... Implementation- Investment Expenses

- Report external and direct internal investment expenses as a component of net investment return
- Exclude those expenses from the presentation of expenses by nature and function
- Establish procedures to accumulate any external and direct internal investment expenses to be netted against investment return

... #6 - Changes to Statement of Cash Flows

- Can continue to use either direct or indirect method
- If the direct method is used, NPOs are no longer required to show the reconciliation of the change in net assets to cash flows from operating activities.
- Other proposed changes deferred to Phase 2

... Operating Cash Flows - Which Presentation is More Informative?

Cash received from contributors	10,700
Cash received from service recipients	5,000
Interest and dividends received	8,600
Miscellaneous receipts	100
Cash paid to employees	(13,500)
Cash paid to suppliers	(5,700)
Interest paid	(400)
Grants paid	(5,700)
Net cash used by operating activities	<u>(900)</u>

Direct Method

Cash flows from operating activities:

Change in net assets	\$ 16,600
Adjustments to reconcile change in net assets to net cash	
Depreciation	3,000
Net gains on investments	(15,800)
Net gain on sale of equipment	(120)
Net change in operating assets and liabilities -	
Contributions receivable	(880)
Prepaid expenses and other assets	(460)
Accounts payable and accrued expenses	390
Grants payable	870
Contributions restricted for long-term investments	(4,500)
	<u>(17,500)</u>
Net cash used by operating activities	<u>(900)</u>

Indirect Method

... #7 - Liquidity and Availability of Resources Disclosures

- Qualitative information on how a NFP manages its liquid resources available to meet cash needs for general expenditures within one year (in footnotes)
- Quantitative information that communicates the availability of the financial assets (cash, accounts receivable, investments) to meet cash needs for general expenditures within one year (on statement of financial position and/or in footnotes)
 - Availability may be affected by
 - Nature of the assets
 - External limits imposed by donors, laws, and contracts with others
 - Internal limits imposed by board directors

... Implementation

- Identify all financial assets and any limitations on availability for expenditure in the next 12 months
- 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
- Availability is affected by nature of the asset, external limitations imposed by donors, contractual agreements, and board designations

... Implementation (continued)

- Determine whether presenting a classified statement of financial position (SOFP) could enhance or simplify the quantitative disclosure requirements (considering other effects elsewhere in the FS and notes)
- Develop a formal policy for managing the organization's liquidity needs
 - Will be disclosed in the qualitative portion of the note disclosure
- Draft the note disclosure describing how the entity manages its liquid assets and liquidity needs. This includes:
 - 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

Quantitative Availability Disclosure

The following represents Big National Charity's financial assets at December 31, 20XX and 20XX:

Financial assets at year end:	20XX	20XX
Cash and cash equivalents	\$ 1,740,000	\$ 920,000
Contributions receivable	244,000	409,000
Investments	1,158,000	677,000
Total financial assets	3,142,000	2,006,000
Less amounts not available to be used within one year:		
Net assets with donor restrictions	1,045,000	1,192,000
Less net assets with purpose restrictions to be met in less than a year	-	(7,000)
Quasi endowment established by the board	205,000	130,000
	1,250,000	1,315,000
Financial assets available to meet general expenditures over the next twelve months	\$ 1,892,000	\$ 691,000

... Qualitative Liquidity Disclosures

- Big National Charity's goal is generally to maintain financial assets to meet 90 days of operating expenses (approximately \$1.4 million). As part of its liquidity plan, excess cash is invested in short-term investments, including money market accounts and certificates of deposit. Big National Charity has a \$250,000 line of credit available to meet cash flow needs.

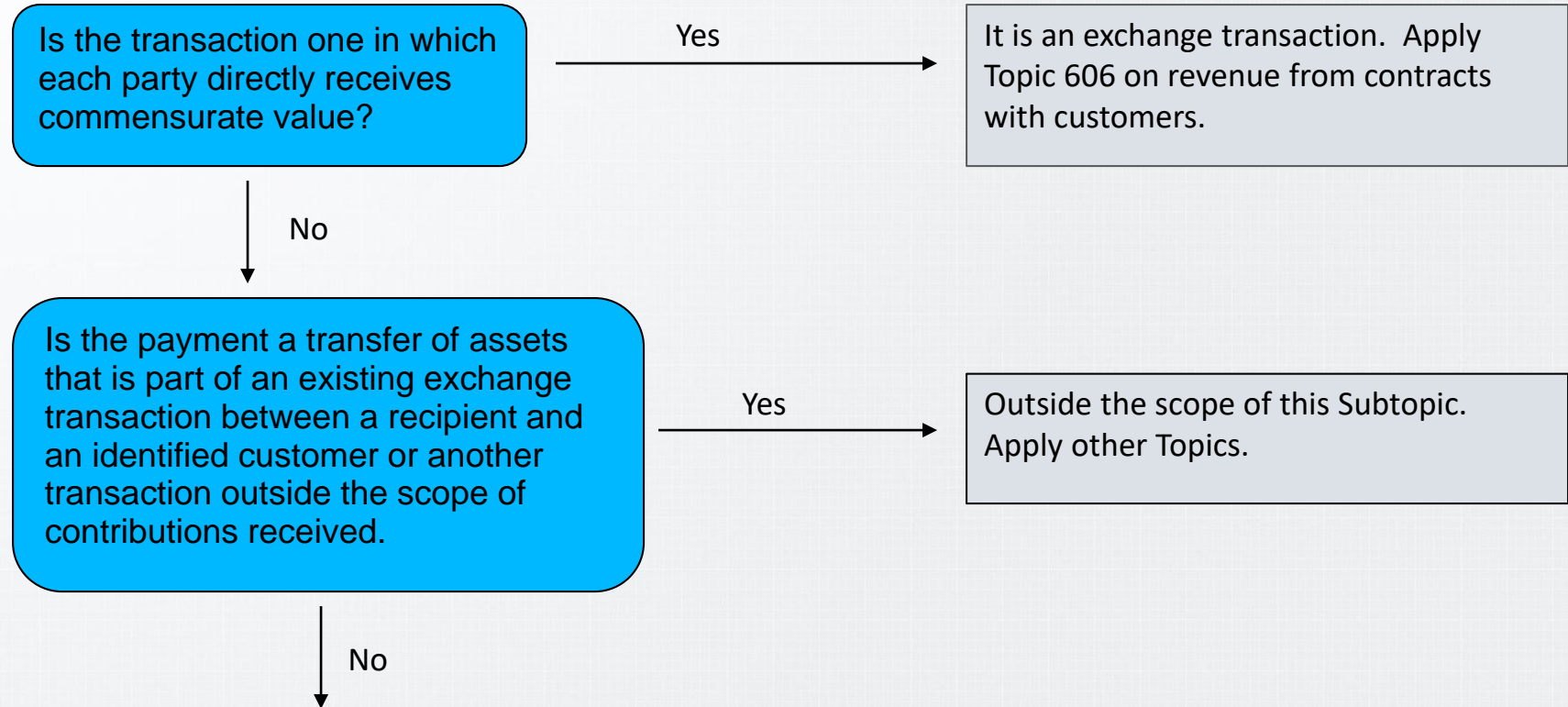
... Additional Qualitative Liquidity Disclosures

- The organization receives significant contributions and promises to give restricted by donors, and considers contributions restricted for programs which are ongoing, major, and central to its annual operations to be available to meet cash needs for general expenditures. The organization manages its liquidity and reserves following three guiding principles: operating within a prudent range of financial soundness and stability, maintaining adequate liquid assets to fund near-term operating needs, and maintaining sufficient reserves to provide reasonable assurance that long-term obligations will be discharged. The organization has a liquidity policy to maintain current financial assets less current liabilities at a minimum of 30 days operating expenses. The organization has a policy to target a year-end balance of reserves of unrestricted, undesignated net assets to meet 15 to 30 days of expected expenditures. To achieve these targets, the entity forecasts its future cash flows and monitors its liquidity quarterly, and monitors its reserves annually. During the years ended December 31, 2018 and 2017, the level of liquidity and reserves was managed within the policy requirements.

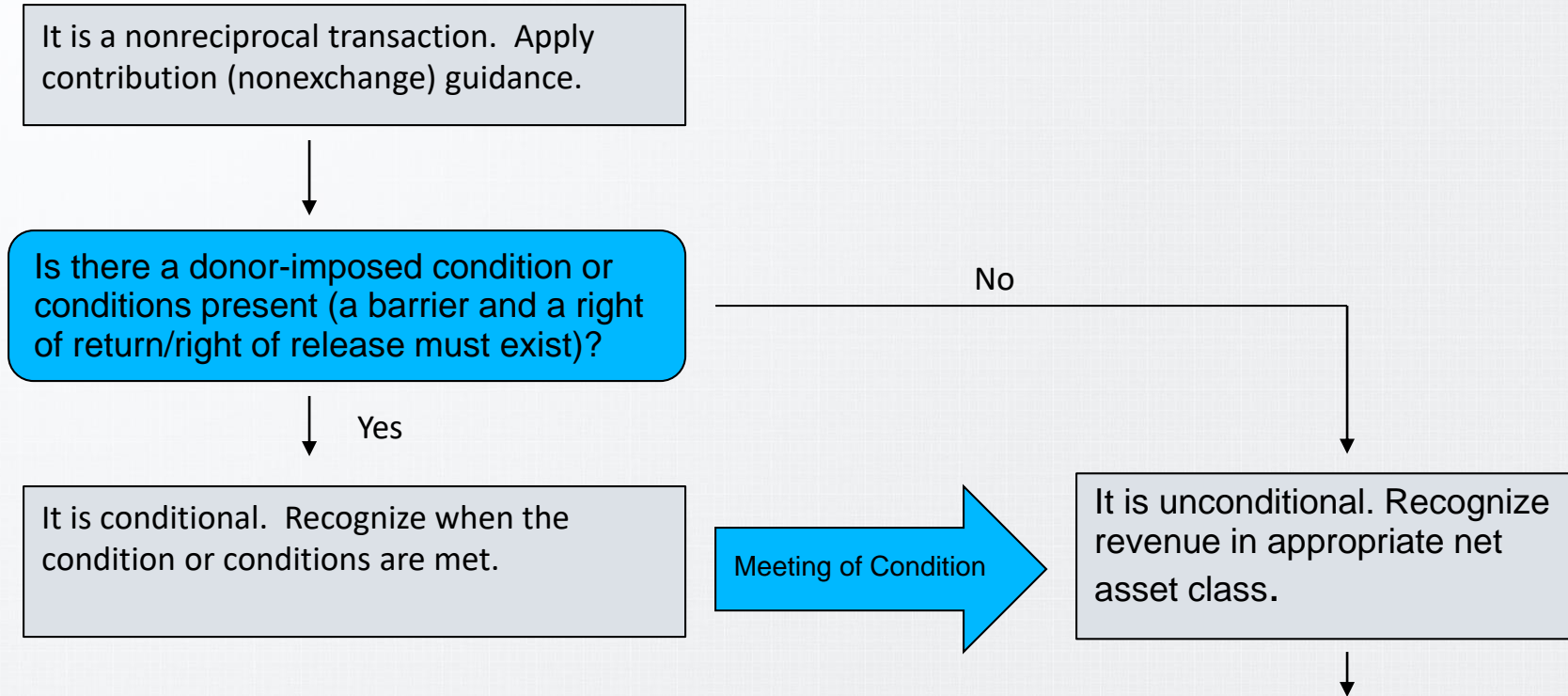
... Accounting Standards Update – Contributions Received and Made

- The FASB issued ASU 2018-08 in June 2018 clarifying the scope and the accounting guidance for contributions received and contributions made.
- The amendments will assist entities in:
 - Evaluating whether transactions should be accounted for as contributions within the scope of Topic 958 or as ;
 - Exchange transactions subject to Topic 606 – Revenue from Contracts with Customers.
 - Further to distinguish between conditional contributions and unconditional contributions.

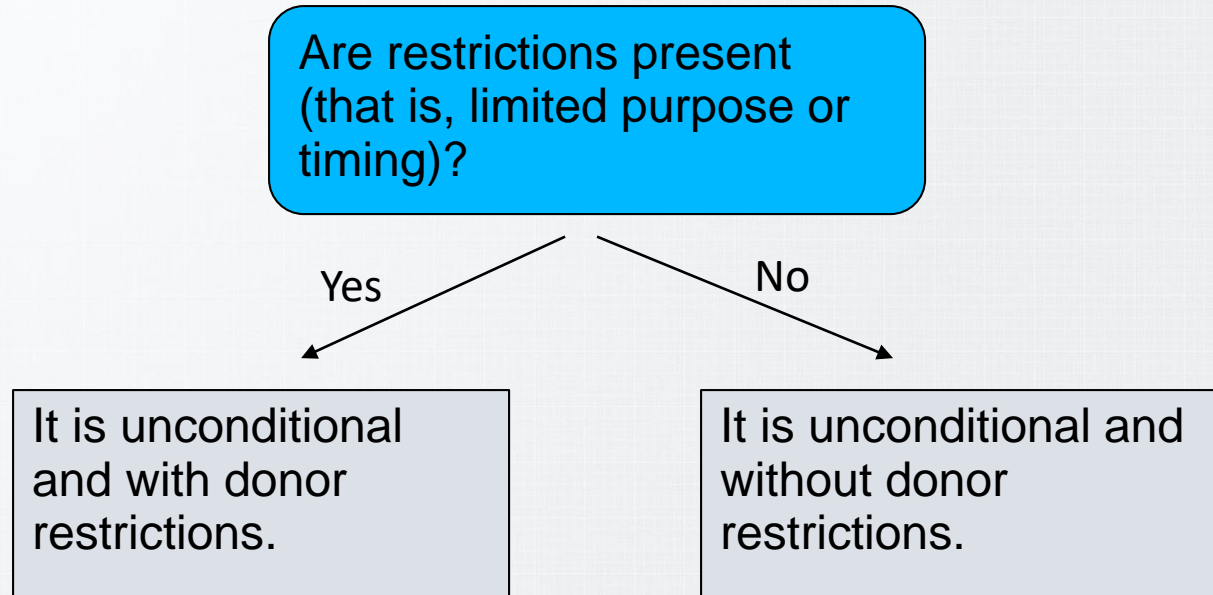
... Accounting Standard Update – Contributions Received and Made



... Accounting Standard Update – Contributions Received and Made



... Accounting Standard Update – Contributions Received and Made



... Accounting Standard Update – Contributions Received and Made

If the transaction is deemed to be a contribution then the following needs to be considered:

- Donor Imposed Condition – new definition
 - a. Is there a barrier the nonprofit must overcome to be entitled to the resources provided and
 - b. Does the contributor retain either a right of return to the resources provided or a right of release of promisor from its obligation to transfer resources.
- Barrier
 - a. The nonprofit is required to achieve a measurable outcome (help a specific number of beneficiaries or produce a certain number of units).
 - b. The nonprofit is required to overcome a barrier related to the primary purpose of the agreement (this excludes trivial or administrative requirements).
 - c. The nonprofit has limited discretion over how the resources are spent (a requirement to follow specific guidelines about incurring qualifying expenses).

... Accounting Standard Update – Contributions Received and Made

- Effective Dates – for most organizations
 - For **resource recipients** - annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019 (Calendar year 2019)
 - For **resource providers** - annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020 (Calendar year 2020)
- Transition
 - Modified prospective basis; retrospective basis is permitted
- Disclosure
 - The nature of and reason for the accounting change. An explanation of the reasons for significant changes in each financial statement line item in the current annual or interim period resulting from applying the amendments instead of the previous guidance.

Questions



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