Learning Objectives

• At the end of this session you will be able to:
  – Discuss why we prepare audited financial statements and the resources available in preparation.
  – Identify the requirements in FASB’s new financial statement standard and changes for not-for-profits to consider as well as implementation techniques that could assist in converting a not-for-profit’s financial statements and footnotes to the new standard.
  – Distinguish between contribution and exchange transactions and conditional and unconditional contributions and grants.
  – Discuss timing of contribution and grant revenue recognition
  – Identify and apply other GAAP relevant to foundations.
We’re Not Publicly Traded – Why Audited Financial Statements?

Many States, Federal Grant-making Agencies, and Institutional Donors require nonprofits have audited financial statements.
Who Are the Standard Setters?

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

Has statutory authority to establish financial accounting and reporting standards for publicly held companies

Delegates this to private sector

**FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)**

Private sector organization designated by SEC to establish standards for financial accounting that govern the preparation of financial reports by nongovernmental organizations
FOR AN ‘UNMODIFIED OPINION,’ STATEMENTS MUST BE ISSUED IN ACCORDANCE WITH GAAP

<table>
<thead>
<tr>
<th>FASB</th>
<th>AICPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishes GAAP (\text{(Generally Accepted Accounting Principles)}) for preparing audited nonprofit organizations</td>
<td>Sets U.S. auditing standards for audits of private companies, nonprofit organizations and government</td>
</tr>
</tbody>
</table>
What Resources Do We Have?

ACCOUNTING STANDARDS CODIFICATION (ASC)
- Can be found on FASB.org under “standards”
- Basic View is free
- Professional View
  - Has a fee but increased capability

AICPA
Not-for-Profit Entities Audit and Accounting Guide
Accounting Standards Codification (ASC)

- Single source of authoritative U.S. GAAP
  - Effective July 1, 2009
  - Superseded all existing FASB, AICPA, EITF and related literature
- GAAP did not change
- Updates (ASUs) are not authoritative in their own right – FASB does not amend updates – only Topics
- TOPIC 958 Not-for-Profit Entities incorporate rules uniquely applicable to the sector
  - Other topics still apply
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Overview of the New Financial Statement Presentation Standard
NFP Financial Statements ASU – Key Objectives (recommended by FASB’s NFP Advisory Committee (NAC))

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about: financial performance, cash flows, and liquidity
- Better enable NFPs to “tell their financial story”

Issued August 18, 2016, ASU No. 2016-14
ASU 2016-14 Changes

- New liquidity and availability disclosures required
- Net asset classes reduced from three to two
- Additional disclosures for underwater endowments
- All not-for-profits (NFPs) must report expenses by nature and function in one place, and describe the methods used to allocate among functional categories
- Net investment return replaces other alternatives
- Use of direct method in a statement of cash flows eliminates reconciliation of change in net assets to cash flows from (used for) operating activities
Tools - Implementation Checklist

General Implementation

1) The presentation of financial statements for Not-for-Profit (NFP) entities is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early application is permitted.
   a) Has your organization decided to early adopt the new provisions or plan to adopt at the above noted effective date?
   b) Has your organization drafted a footnote for a change in accounting principal?
   c) Have proper individuals attended training to understand the new changes in financial reporting?
   d) Has your organization discussed with its auditors the impact of the new changes related to audit timing and planning?
   e) Has your organization identified the team members who will lead the implementation of the new financial reporting requirements?

2) The new guidance shall be applied on a retrospective basis. However, if presenting comparative financial statements, an NFP would have the option to omit the following information for any periods presented before the year of adoption: i) Analysis of expenses by both functional and natural classification, ii) Disclosures about liquidity and availability of resources.
   a) Does your organization present comparative financial statements? If so, while analyzing the below steps remember that retrospective application is required, except for the omissions noted above.

3) In the year of adoption, an NFP shall disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for each year presented.
   a) Has your organization identified restatements and reclassifications?
   b) If the above answer is yes, has a footnote been drafted noting the nature and effects on changes in the net asset classes for year presented?
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Liquidity and Availability of Resources
New Requirements

NFPs required to provide:

**Qualitative** information on how an NFP manages its liquid available resources and its liquidity risk (in the notes)

**Quantitative** information that communicates the availability of an NFP’s financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)
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Net Assets
Net Assets

Current GAAP

- Unrestricted
- Temp. Restricted
- Perm. Restricted

Revised GAAP + Disclosures

- Without Donor Restrictions*
- With Donor Restrictions*

- Amount, purpose, and type of board designations**
- Nature and amount of donor restrictions

* NFPs may choose to disaggregate further
** New disclosure requirement
Net Asset Classification Requirements

- **Two classes**
  - With donor/grantor-imposed restrictions; and time restrictions
    - Includes perpetual and temporary
  - Without donor/grantor-imposed restrictions
    - Includes board-designated

- **Disclosure requirements**
  - Composition of net assets with donor/grantor restrictions
  - Emphasis on how/when resources (net assets) can be used
    - Specified purpose(s)
    - Specified time(s)
    - Perpetual (endowment, i.e., “funds of perpetual duration”)
  - Quantitative and qualitative information about board designations
Board-Designated Net Assets

- NFPs must disclose the nature and amounts of board-designated net assets
- Subject to self-imposed limits set by governing board for programs, investment, contingencies, fixed asset acquisition, major repairs, or other uses
- Designation decisions may be delegated to management
- NFPs need to have policies and procedures on the establishment of board-designated net assets, conditions under which net assets are to be designated, in what amounts, and how such net assets may be spent down (i.e., released from designation)
Example Balance Sheet Presentation

Net assets:
- Without donor restrictions: 97,677
- With donor restrictions: 115,657
- Total net assets: 213,334

Alternative disaggregation allowed

Net Assets [The level of detail presented here is not required, however, if the information presented on the face is not sufficiently detailed, it must be included in the notes.]

<table>
<thead>
<tr>
<th>Description</th>
<th>Without donor restrictions</th>
<th>With donor restrictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undesignated</td>
<td>3,057,607</td>
<td>1,370,401</td>
</tr>
<tr>
<td>Designated by the Board for operating reserve</td>
<td>300,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Designated by the Board for endowment</td>
<td>15,511,186</td>
<td>14,912,222</td>
</tr>
<tr>
<td>Invested in property and equipment, net of related debt</td>
<td>21,150,885</td>
<td>20,193,878</td>
</tr>
</tbody>
</table>

Total: 40,019,678                                       36,726,501

With donor restrictions
- Perpetual in nature: 22,864,750
- Purpose restrictions: 14,228,316
- Time-restricted for future periods: 1,391,825
- Underwater endowments: -42,677

Total: 38,484,891                                       34,038,338

Total net assets: 78,504,569                             70,764,839

Total liabilities and net assets: $94,314,447            $86,137,541

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Endowments
Endowment Refresher
Endowment Definitions

- **UPMIFA**: An institutional fund or part thereof that, under the terms of the gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use.

- **GAAP**: An established fund of cash, securities, or other assets, held to provide income for the maintenance of a not-for-profit organization.
(Current) Required Disclosures

- Description of the governing board’s interpretation of the law(s) that underlies the organization’s net asset classifications
- Description of the organization’s endowment spending policy(ies) for the appropriation of endowment assets for expenditure
- Description of the organization’s endowment investment policies including:
  - The organization’s return objectives and risk parameters
  - How those objectives relate to the organization’s endowment spending policy(ies)
  - Strategies employed for achieving those objectives
(Current) Required Disclosures

- Description of the composition of the organization’s endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor restricted endowment funds separately from board-designated endowment funds.

- Reconciliation of the beginning and ending balance of the organization’s endowment, in total and by net asset class, including, at a minimum, the following (as applicable):
  - Investment income (interest, dividends)
  - Appreciation or depreciation
  - Contributions
  - Amounts appropriated for expenditure
  - Reclassifications
  - Other changes
Endowment Update
Underwater Endowments

• Now Defined in 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

• The entire balance of the endowment fund is reported in the “with donor restrictions” class of net assets
Underwater Endowments

• New disclosure requirements:
  – Interpretation of the NFP’s ability to spend from underwater endowment funds
  – NFP’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 amount exceeds the fair value (the deficiency = 2 less 1)
Example Endowment Disclosure

As of December 31, 20X1 and 20X0, we had the following endowment net asset composition by type of fund:

<table>
<thead>
<tr>
<th>12/31/20X1</th>
<th>Without Donor Restriction</th>
<th>With Donor Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board-designated endowment funds</td>
<td>$ 15,511,186</td>
<td>$</td>
<td>$ 15,511,186</td>
</tr>
<tr>
<td>Donor-restricted endowment funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor</td>
<td>-</td>
<td>19,174,849</td>
<td>19,174,849</td>
</tr>
<tr>
<td>Accumulated investment gains</td>
<td>-</td>
<td>12,678,095</td>
<td>12,678,095</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 15,511,186</strong></td>
<td><strong>$ 31,852,944</strong></td>
<td><strong>$ 47,364,130</strong></td>
</tr>
</tbody>
</table>

From time to time, certain donor-restricted endowment funds may have fair values less than the amount required to be maintained by donors or by law (underwater endowments). We have interpreted UPMIFA to permit spending from underwater endowments in accordance with prudent measures required under law. At December 31, 20X0, funds with original gift values of $19,883,738, fair values of $19,841,061, and deficiencies of $42,677 were reported in net assets with donor restrictions. These amounts were fully recovered during 20X1 due to favorable market fluctuations.
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Functional Expenses
Requirements for Reporting Expenses

• All NFPs, including Voluntary Health and Welfare Entities must present an analysis of expenses by function and nature in one location
  – 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 & general expenses
## Consolidated Statement of Functional Expenses

Year Ended December 31, 20X1

<table>
<thead>
<tr>
<th>Advisory</th>
<th>Program Services</th>
<th>Total</th>
<th>Management and General</th>
<th>Fundraising and Development</th>
<th>Cost of Goods Sold</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants and other assistance</td>
<td>$294,261</td>
<td>$294,261</td>
<td>$294,261</td>
<td>$294,261</td>
<td>$294,261</td>
<td>$294,261</td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>6,769,754</td>
<td>1,061,585</td>
<td>7,831,339</td>
<td>370,234</td>
<td>254,176</td>
<td>-</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>1,398,503</td>
<td>310,865</td>
<td>1,709,368</td>
<td>99,963</td>
<td>26,222</td>
<td>$1,835,533</td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>541,580</td>
<td>84,927</td>
<td>626,507</td>
<td>29,619</td>
<td>19,823</td>
<td>675,949</td>
</tr>
<tr>
<td>Professional services</td>
<td>1,306,807</td>
<td>87,197</td>
<td>1,394,004</td>
<td>12,780</td>
<td>1,704</td>
<td>1,408,488</td>
</tr>
<tr>
<td>Accounting fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>40,073</td>
<td>-</td>
<td>40,073</td>
</tr>
<tr>
<td>Legal fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>7,939</td>
<td>7,939</td>
</tr>
<tr>
<td>Advertising and promotion</td>
<td>33,085</td>
<td>21,006</td>
<td>54,091</td>
<td>79,261</td>
<td>132,478</td>
<td>265,830</td>
</tr>
<tr>
<td>Office expenses</td>
<td>87,071</td>
<td>56,654</td>
<td>143,725</td>
<td>9,867</td>
<td>22,794</td>
<td>176,286</td>
</tr>
<tr>
<td>Information technology</td>
<td>37,588</td>
<td>606,535</td>
<td>644,523</td>
<td>12,399</td>
<td>14,653</td>
<td>671,445</td>
</tr>
<tr>
<td>Occupancy</td>
<td>446,601</td>
<td>29,799</td>
<td>476,400</td>
<td>14,918</td>
<td>55,427</td>
<td>546,745</td>
</tr>
<tr>
<td>Travel</td>
<td>170,957</td>
<td>18,283</td>
<td>189,240</td>
<td>149,292</td>
<td>-</td>
<td>338,532</td>
</tr>
<tr>
<td>Conferences, conventions and meetings</td>
<td>32,516</td>
<td>66,287</td>
<td>98,803</td>
<td>11,505</td>
<td>-</td>
<td>110,308</td>
</tr>
<tr>
<td>Interest</td>
<td>387,428</td>
<td>-</td>
<td>387,428</td>
<td>54,957</td>
<td>-</td>
<td>396,465</td>
</tr>
<tr>
<td>Insurance</td>
<td>196,174</td>
<td>12,256</td>
<td>210,430</td>
<td>5,443</td>
<td>1,012</td>
<td>217,195</td>
</tr>
<tr>
<td>Training and development</td>
<td>457,617</td>
<td>20,659</td>
<td>478,276</td>
<td>9,113</td>
<td>33,669</td>
<td>521,058</td>
</tr>
<tr>
<td>Gift shop cost of goods sold</td>
<td>59,621</td>
<td>59,621</td>
<td>-</td>
<td>-</td>
<td>59,621</td>
<td>-</td>
</tr>
<tr>
<td>Cost of direct benefits to donors</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12,601</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>1,147,186</td>
<td>74,425</td>
<td>1,221,611</td>
<td>20,112</td>
<td>13,960</td>
<td>1,255,683</td>
</tr>
<tr>
<td>Bad debt expense</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>16,892</td>
<td>-</td>
<td>16,892</td>
</tr>
<tr>
<td>Other</td>
<td>31,509</td>
<td>5,977</td>
<td>37,486</td>
<td>2,122</td>
<td>7,474</td>
<td>47,142</td>
</tr>
<tr>
<td>Total expenses by function</td>
<td>13,400,588</td>
<td>2,464,694</td>
<td>15,865,282</td>
<td>883,593</td>
<td>592,859</td>
<td>12,601</td>
</tr>
</tbody>
</table>

### Loss expenses included with revenues

- Gift shop cost of goods sold
- Cost of direct benefits to donors

### Total expenses included in the expense section on the statement of activities

| $13,340,967 | $2,464,694 | $15,805,661 | $883,593 | $592,859 | $12,601 | $17,282,113 |
## Option to Present on Statement of Activities

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Grant activities</strong></td>
<td></td>
</tr>
<tr>
<td>Grants</td>
<td>12,125</td>
</tr>
<tr>
<td>Salaries, benefits and taxes</td>
<td>1,808</td>
</tr>
<tr>
<td>Occupancy costs</td>
<td>970</td>
</tr>
<tr>
<td>Depreciation</td>
<td>845</td>
</tr>
<tr>
<td>Supplies</td>
<td>1,255</td>
</tr>
<tr>
<td>Other</td>
<td>56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>17,059</td>
</tr>
<tr>
<td><strong>Management and general</strong></td>
<td></td>
</tr>
<tr>
<td>Salaries, benefits and taxes</td>
<td>452</td>
</tr>
<tr>
<td>Occupancy costs</td>
<td>243</td>
</tr>
<tr>
<td>Depreciation</td>
<td>211</td>
</tr>
<tr>
<td>Supplies</td>
<td>314</td>
</tr>
<tr>
<td>Other</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,234</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>18,293</td>
</tr>
</tbody>
</table>
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 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
When to Allocate M&G Expenses

- Activities that represent **direct conduct** or **direct supervision** of program or other supporting activities require allocation from management & general activities to those program or other supporting activities.

- Examples from the ASU:
  - IT - benefits various functions and generally would be allocated.
  - 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.
Example Allocation Method Disclosure

Note 13 - Functionalized Expenses

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include occupancy, depreciation, and amortization, which are allocated on a square footage basis, as well as salaries and wages, benefits, payroll taxes, professional services, office expenses, information technology, interest, insurance, and other, which are allocated on the basis of estimates of time and effort.

[All NFPs are required to report this information either on the face of the statement of activities, as a schedule in the notes to the financial statements, or as a separate financial statement. Presenting this information as supplementary information does not meet the requirement]
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Investment Return
Net Investment Return

- Presented 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
Net 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, including supervising, selecting and monitoring external managers
  - Excludes costs not associated with generating investment return, such as administrative management, contracts, and pooled-fund administration
Programmatic Investments Excluded

• This guidance is not applicable to programmatic investments
  
  – Programmatic Investing: The activity of making loans or other investments that are directed at carrying out a not-for-profit entity’s purpose for existence rather than investing in the general production of income or appreciation of an asset (for example, total return investing). An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.
Statement of Cash Flows

• NFPs may use either the direct or indirect method

• If the direct method is used, NFPs are no longer required to show the reconciliation of the change in net assets to cash flows from operating activities

• Other proposed changes under consideration were deferred to Phase 2:
  – Reclassifications among types of activities (i.e. operating, investing and financing)
  – Changes to improve alignment of the statement of cash flows with the statement of activities
Operating Cash Flows – Which is Better?

- User surveys indicate a strong preference of the direct method – FASB is listening!

**Direct Method**

<table>
<thead>
<tr>
<th>Cash flows from operating activities:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash received from contributors</td>
<td>10,645</td>
</tr>
<tr>
<td>Cash received from service recipients</td>
<td>5,020</td>
</tr>
<tr>
<td>Interest and dividends received</td>
<td>8,570</td>
</tr>
<tr>
<td>Miscellaneous receipts</td>
<td>150</td>
</tr>
<tr>
<td>Cash paid to employees</td>
<td>(13,400)</td>
</tr>
<tr>
<td>Cash paid to suppliers</td>
<td>(5,658)</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(382)</td>
</tr>
<tr>
<td>Grants paid</td>
<td>(5,175)</td>
</tr>
<tr>
<td>Net cash used by operating activities</td>
<td>(230)</td>
</tr>
</tbody>
</table>

**Indirect Method**

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

**Years Ended December 31, 20X1 and 20X0**

<table>
<thead>
<tr>
<th>Description</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows from Operating Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program service payments received</td>
<td>$13,410,429</td>
<td>$12,459,235</td>
</tr>
<tr>
<td>Membership receipts</td>
<td>373,781</td>
<td>355,044</td>
</tr>
<tr>
<td>Gift shop sales receipts</td>
<td>112,364</td>
<td>107,677</td>
</tr>
<tr>
<td>Receipts from federal and state contracts and grants</td>
<td>256,663</td>
<td>285,129</td>
</tr>
<tr>
<td>Contributions received, net of amounts restricted for long-term purposes</td>
<td>4,264,113</td>
<td>2,647,976</td>
</tr>
<tr>
<td>Receipts from social events</td>
<td>114,989</td>
<td>272,402</td>
</tr>
<tr>
<td>Distributions from beneficial interests and assets held by others</td>
<td>182,521</td>
<td>135,717</td>
</tr>
<tr>
<td>Other cash receipts</td>
<td>101,275</td>
<td>82,710</td>
</tr>
<tr>
<td>Grants and</td>
<td>(294,261)</td>
<td>(288,376)</td>
</tr>
<tr>
<td>Payments for salaries, benefits and payroll taxes</td>
<td>(10,064,076)</td>
<td>(10,734,090)</td>
</tr>
<tr>
<td>Payments to vendors</td>
<td>(3,935,159)</td>
<td>(4,086,056)</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(441,514)</td>
<td>(493,767)</td>
</tr>
<tr>
<td><strong>Net Cash from Operating Activities</strong></td>
<td>$3,160,524</td>
<td>(762,691)</td>
</tr>
<tr>
<td><strong>Cash Flows from Investing Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases of operating investments</td>
<td>(275,000)</td>
<td>(150,000)</td>
</tr>
<tr>
<td>Proceeds from sales of operating investments</td>
<td>173,320</td>
<td>109,761</td>
</tr>
<tr>
<td>Purchases of property and equipment</td>
<td>(1,407,916)</td>
<td>(875,496)</td>
</tr>
<tr>
<td>Proceeds from sales of property and equipment</td>
<td>(3,920,000)</td>
<td>(3,920,000)</td>
</tr>
<tr>
<td>(Addition to) cash restricted to building project</td>
<td>(300,000)</td>
<td>-</td>
</tr>
<tr>
<td>(Addition to) withdrawal from assets held under split-interest agreements</td>
<td>88,416</td>
<td>(68,359)</td>
</tr>
<tr>
<td>(Addition to) withdrawal from endowment</td>
<td>541,471</td>
<td>(342,531)</td>
</tr>
<tr>
<td><strong>Net Cash from Investing Activities</strong></td>
<td>(1,379,249)</td>
<td>(1,259,695)</td>
</tr>
<tr>
<td><strong>Cash Flows from Financing Activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collections of contributions restricted to building project</td>
<td>500,000</td>
<td>-</td>
</tr>
<tr>
<td>Collections of contributions restricted to endowment</td>
<td>365,963</td>
<td>1,891,105</td>
</tr>
<tr>
<td>Payments to beneficiaries of split-interest agreements</td>
<td>(76,388)</td>
<td>(87,219)</td>
</tr>
<tr>
<td>Proceeds from establishment of split-interest agreements</td>
<td>(50,000)</td>
<td>107,899</td>
</tr>
<tr>
<td>Net borrowings (repayments) under line of credit</td>
<td>-</td>
<td>(275,000)</td>
</tr>
<tr>
<td>Proceeds from issuance of bonds and notes</td>
<td>-</td>
<td>125,000</td>
</tr>
<tr>
<td>Principal payments on bonds, notes and social leases</td>
<td>(203,526)</td>
<td>(423,588)</td>
</tr>
<tr>
<td><strong>Net Cash from Financing Activities</strong></td>
<td>$514,139</td>
<td>1,888,211</td>
</tr>
</tbody>
</table>

**Net Change in Cash and Cash Equivalents**  
20X1: $2,335,424  
20X0: $1,391,123  

**Cash and Cash Equivalents, Beginning of Year**  
20X1: $3,485,916  
20X0: $2,024,792  

**Cash and Cash Equivalents, End of Year**  
20X1: $5,821,349  
20X0: $3,485,916
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Other Considerations
Effective Date, Early Adoption, and Transition

**Effective Date:** For fiscal years beginning after 12/15/2017 (e.g., CY 2018, FY 2018-19)
- Interim financials the following year

**Early Adoption:** Permitted, but must apply the regular transition provisions.
- 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

**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
Early Adoption

• Early adoption permitted, but must apply the regular transition provisions

• Example of early adoption:
  – NFP chooses to early adopt in CY 2017
  – NFP must apply all provisions to CY 2017 financials
  – NFP presents comparative financials for CY 2016; must apply all provisions to the CY 2016 financials, except NFP can choose not to present:
    ◊ Analysis of expenses by nature and function, and/or
    ◊ Disclosures around liquidity and availability of resources
Options Without Early Adopting?

• NFPs are already permitted to make many of the changes in the ASU.

• The only changes that **cannot** be made without formally adopting the ASU are:
  – Presenting one class of restricted net assets (i.e., consolidating temporarily and permanently restricted net assets into net assets with donor restrictions)
  – Underwater endowment accounting
  – Eliminating disclosures of investment return components and netted expenses
  – Eliminating requirement to provide indirect reconciliation if using the direct method for operating cash flows
Disclosures and Auditor’s Reports

• Required disclosures:
  – In year of adoption, disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for each period presented.

• Auditor’s reports:
  – In year of adoption, include an emphasis-of-matter paragraph in the auditor’s report if the adoption results in changes that have a material effect on the financial statements (AU-C 708.07)
Implementation – Overall

• Read the ASU
• Identify the individual(s) who will lead the implementation of the ASU
• Ensure all individuals attend training to understand the changes required by the ASU
• Discuss the impact of the new changes on audit timing and planning with your auditors
• Make a practice run by recasting your last audited FS and notes
• Decide: early adopt, wait, or two-stage?
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Changes to Nonprofit Revenue
Recognition
Updates to ASC 958-605 – Accounting for Contributions
Received and Contributions Made
Project Timeline

- **Issued Proposed Update**: August 3, 2017
- **Comment Period Deadline**: November 1, 2017
- **Final ASU**: Q2 2018
Scope

- Applies to **all entities** (NFPs and business entities) that receive or make contributions, unless otherwise indicated.
- Excludes transfer of assets from the government to business entities.
- Applies to both contributions received by a recipient and contributions made by a resource provider. *The intent is simply that both apply the same guidance, the entities do not need to track each other’s accounting to achieve the same reporting results.*
# Why This Upcoming ASU Is Necessary

To address difficulty and diversity in practice among NFPs in:

<table>
<thead>
<tr>
<th>Issue 1</th>
<th>Characterizing grants and similar contracts with government agencies and others as (i) reciprocal transactions (exchanges) or (ii) nonreciprocal transactions (contributions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue 2</td>
<td>Distinguishing between conditional and unconditional contributions</td>
</tr>
</tbody>
</table>

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We promise to know you and help you.
Issue 1: Grants and Contracts: Reciprocal vs Nonreciprocal (Exchange vs Nonexchange)

• Many NFPs treat federal grants/contracts with governmental entities as exchanges (regardless of substance)

• Some equate the government with general public
  – i.e., the government is merely “purchasing” benefits for taxpayers that it would otherwise have to provide itself
  – Issue is whether government receives direct commensurate value in return (because the public benefits)

• Many believe the government doesn’t give “contributions”
Issue 1: Who Receives the Benefit?

Current Practice

Exchange
- Direct commensurate value to resource provider
- Specified third parties
- General public

Proposed Clarification

Exchange
- Follow Topic 606 (or other, such as Leases)
- Direct commensurate value to resource provider
- Specified third parties
- Government/ resource provider is a 3rd party payer on behalf of customer

Nonexchange
- Follow Topic 958-605
- Specified third parties
- Continue to monitor GASB and IPSASB projects in this area
- General public

*The revenue recognized would actually be the underlying contract’s patient service revenue, tuition revenue, etc.

**A focus on whether or not there is a “performance obligation” could even ultimately include some contracts where the general public is the primary beneficiary.
Reciprocal vs Nonreciprocal – Key Clarifications

• Resource provider is NOT synonymous with the general public
  – Resource provider includes governmental entities, private foundations, and others
  – Indirect benefit received by the public is not equivalent to commensurate value received by the resource provider
  – Indirect benefit received by a resource provider in providing a societal benefit is not equivalent to commensurate value received by the resource provider
  – Furthering a resource provider's mission or positive sentiment from acting as a donor does not constitute commensurate value received by the resource provider
Reciprocal vs Nonreciprocal – Key Clarifications

• The type of resource provider should not override the substance of the transaction

• If the primary beneficiary of a grant or contract is a 3rd party, an NFP must use judgment to determine if the transaction is reciprocal or nonreciprocal
Example: Grant from Federal Government – Reciprocal or Nonreciprocal?

• NFP A is awarded a grant from the federal government
• The agreement requires NFP A to:
  – Follow the rules and regulations established by the OMB
  – Incur certain expenses (or costs) in compliance with rules and regulations established by the OMB and federal awarding agency
  – Obtain an annual audit in accordance with OMB guidelines
  – Submit a summary of research findings to the federal government
• Any unused assets are forfeited and any unallowed costs that have been drawn down by NFP A are required to be refunded
• NFP A retains the rights to the findings
Conclusion

• NFP A concludes this is a nonexchange (nonreciprocal) transaction
  – Commensurate value is not being exchanged between the two parties
  – NFP A retains all rights to the research and findings received and the primary benefit of the findings
  – The federal government’s benefit is considered indirect because the research and findings serve the general public
Issue 2: Conditional vs Unconditional Contributions

- Stakeholders find it difficult to distinguish between conditional and unconditional contributions
  - Leads to diversity in application
- If funds are provided with certain stipulations, there’s difficulty in distinguishing whether contribution is conditional, restricted, or both
- Diversity in application of “remote” notion
  - Whether likelihood of failing to meet a condition is remote
    ◊ Some NFPs believe any condition within their control has remote likelihood of not being met
    ◊ Other NFPs believe that administrative or other trivial “conditions” prevent recognition until satisfied
Issue 2: Conditional vs Unconditional Contributions

For a *donor-imposed* condition to exist it must have BOTH:

- A right of return or release
- A barrier

◊ Proposed ASU includes indicators and examples to assist in determination
Indicators to Determine a Barrier

- The inclusion of measurable performance-related barrier or other measurable barrier
- The extent to which a stipulation limits discretion by the recipient on the conduct of an activity
- The extent to which a stipulation is related to the purpose of the agreement
When is Revenue/Expense Recognized?

Resource Recipients

- When the contribution is no longer conditional
  - No longer a right of return or release
  - No longer a barrier
- Funds received in advance would be recorded as a liability in the recipient’s books

Resource Providers (Donors)

- Contributions made should generally be recognized by the donor at the same time the donee recognizes the contribution received
  - Donor does not recognize until the contribution has become unconditional
  - Follows same determination criteria as donee
Example: Contribution for a New Wing – Conditional or Unconditional?

• NFP B plans to build a new wing on an existing building
• NFP B receives a solicited multi-year grant in the amount of $1 million from an individual to be used for the new wing
• Agreement includes specific building requirements
  – Specified square footage
  – Environmentally friendly LEED certified
• First installment received after NFP B submits architectural designs that meet specifications
• Additional installments paid in intervals as specific requirements within the agreement are met
• If the building is not built according to specifications, the donor is released from its obligation
Conclusion

• NFP B concludes the grant is conditional
  – Includes measurable performance related barriers to overcome
    ◊ Architectural plan including square footage and LEED certification
  – Resource provider is released from obligation to transfer assets if stipulations are not met

• Revenue is recognized as the barriers are overcome
  – The meeting of specifications throughout the build

• Donor records contribution expense as NFP B overcomes barriers
NFP Revenue Recognition Decision Process

Transaction in which each party directly receives commensurate value?*

- Yes
  - Reciprocal transaction. Apply Rev Rec (ASC 606) or other guidance.
- No
  - Nonreciprocal transaction. Apply contribution (non-exchange) guidance.

Conditions present (i.e., right of return/release and barrier)?

- Yes
  - Conditional- Recognize revenue when condition is met

- No
  - Meeting of Conditions
    - Yes
      - Unconditional and restricted
    - No
      - Unconditional and without restrictions (unrestricted)

Resource providers would apply a similar decision making process for recognizing expenses.

*Includes third-party payments on behalf of identified customers. These do not create new revenue.
Transition Approach

- **Effective Date**
  - [Diagram showing timeline with segments A and B]

- **Modified Prospective**
  - Apply to all agreements:
    - Existing at the effective date (only apply to the portion of existing agreements not previously recognized)
    - Entered into after the effective date

- **No restatement of prior amounts recognized**

- **Retrospective Application Permitted**
### Effective Date – Resource Recipients*

<table>
<thead>
<tr>
<th>Annual periods beginning after June 15, 2018, including interim periods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Business Entities</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>NFP that has issued, or is a conduit debt obligor for, securities that are traded, listed, or quoted on exchange or an over-the-counter market</td>
</tr>
</tbody>
</table>

| All other entities |

*NOTE: Effective date for resource providers is one year delay from recipient effective date, with early adoption permitted.*
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Other Relevant GAAP
ASC 958-605-25 - Transfers of Assets to a NFP or Charitable Trust That Raises or Holds Contributions for Others

• Provides guidance for the following types of recipients of donated assets:
  – Intermediaries
  – Agents
  – Specified beneficiaries

• Important definitions
  – Variance Power
  – Unilateral Power
  – Explicitly Grants
Example – CF is Granted Variance Power

- Society raises funds to build an endowment
- Agreement establishes a fund at CF
- Society and CF are NOT financially interrelated entities
- Society solicits gifts to the fund
- Campaign materials state:
  - Endowment will be owned and held by CF
  - Gifts will be invested and the return will be distributed to the Society
    ◊ Subject to CF spending policy and CF right to redirect the return without approval of the donor, the Society, or any other party
Solution

- CF would recognize the FV of the gifts received as assets and as contribution revenue
  - Donors explicitly granted variance power
- Society is precluded from recognizing its potential rights to the assets held by CF
  - Donors explicitly granted variance power
  - Society would recognize its annual grants from CF as contributions
Example – Resource Provider Names Itself as the Specified Beneficiary

- NFP receives a large gift without donor restriction of securities from an individual
- NFP transfers to CF to establish an endowment fund
- Agreement states:
  - The transfer is irrevocable and transferred assets will not be returned to the NFP
  - CF will make annual distribution of the income earned
    ◊ Subject to CF spending policy
  - CF can substitute another beneficiary if NFP ceases to exist or governing board of CF votes that support of NFP is no longer necessary.
- Neither entity can appoint members to each others boards
Solution

- CF would recognize FV of transferred securities as:
  - Increase in investments
  - Liability to NFP
- NFP would recognize FV of securities from the individual as contribution revenue
- NFP would recognize transfer to CF as:
  - Decrease in investments
  - Increase in an asset (beneficial interest)
- NFP would recognize certain disclosures
Beneficiary Disclosures

- Identity of the recipient entity
- Whether variance power was granted to the recipient entity
  - If so, description of the terms of the variance power
- Terms under which amounts will be distributed to the resource provider
- Aggregate amount recognized in the statement of financial position for those transfers and how recorded
  - Interest in the net assets of the recipient
  - Another asset
Fair Value Measurement
ASC 820

1. Defines Fair Value

2. Sets out a framework for measuring fair value

3. Requires certain disclosures about fair value measurements
FAIR VALUE DEFINED

The price that would be received to **SELL** [EXIT PRICE] an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
Fair Value Measurement

KEY CONCEPTS OF FRAMEWORK

- Orderly transaction, not forced sale
- Exit in the most advantageous market, considered from perspective of reporting entity
- Highest and best use of asset, or credit standing for liability
- Active market – high transaction volume in which entity could sell asset
- Valuation techniques used must be market approach, income approach or cost approach
Establishing Fair Value

ENTITY MUST PRIORITIZE INPUTS [ASSUMPTIONS] USED IN VALUATION TECHNIQUES

Level I – quoted prices for identical assets or liabilities in active markets
Level II – not level I, but still observable – such as using yield curves or market data for like assets, but not identical
Level III - unobservable inputs – compilation of data that collectively supports valuation, using acceptable valuation techniques
Practical Expedient – Net Asset Value (NAV)

• A reporting entity is permitted, as a practical expedient, to estimate the fair value of an investment using the net asset value per share (NAV)
• Applied on an investment by investment basis and applied consistently
• Exceptions to when it can be used
• Amounts are not categorized in the FV Hierarchy
  – Permitted to include a reconciliation
• Requires certain additional disclosures
ASC 820 Disclosures

• Fair value of assets
• Level within the FV hierarchy (tabular)
  – Level I, Level II, Level III
• If the highest and best use of a nonfinancial asset differs from current use, must disclose
• Transfers between Level I and Level II
• For Level II and Level III:
  – Description of valuation techniques and inputs used
  – If a change in valuation approach or technique, the reason for that change
ASC 820 Disclosures – Level III

- Quantitative information regarding significant unobservable inputs used
- Reconciliation from opening to ending balances disclosing:
  - Total gains and losses for the period and the line item on the statement of activities
  - Purchases, sales, issues, settlement (each separately)
  - Transfers in/out of Level III
- Total gains or losses for the period that is attributable to the change in unrealized gains or losses relating to assets still held at the end of the reporting period, and the line item in the statement of activities
ASC 820 Disclosures – Level III

• A description of the valuation processes used
• A narrative description of the sensitivity of the FV measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower FV measurement
Question: Who has the responsibility for determining the fair market value of your assets?

1. Your investment advisor or investment managers, or
2. Your auditors, or
3. You, the reporting entity?
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319.558.0247
Implementation – Liquidity and Availability of Resources

• 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 – Liquidity and Availability of Resources

• Determine whether presenting a classified 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 articulated in the qualitative portion of the note disclosure

• 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, and any other information useful in understanding the entity’s liquidity
Implementation – 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 (SOFP) vs in the notes
Implementation – Board-Designations

• Assemble information about the amounts and purposes of board designations of net assets without donor restrictions to be provided 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 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 – 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
- Remember that the underwater portion of endowments is now presented entirely in funds with donor restrictions
Implementation – Endowments

• Remember that investment return is now presented net of external and direct internal investment expenses, and does not require a separate break-out of the components of investment return

• Determine the changes needed to properly identify direct internal investment expenses if you haven’t been doing this before now
Implementation – Expenses

• Determine where/how to present all expenses by nature and function in one place
  – In a statement of functional expenses
  – In the statement of activities
  – In a note to the financial statements
  – Note - presentation in a supplementary schedule is prohibited

• If not already in place, develop formal allocation methodologies to be used to allocate expenses among programs and supporting services

• Draft the note disclosure of the methods utilized in the allocation process
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 the investment expenses to be netted against investment return
Implementation - Statement of Cash Flows

• If using the direct method, eliminate the reconciliation of the change in net assets to the net cash provided by (used in) operating activities

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