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CLA National Association Conference

Accounting Update

Learning Objectives

- Implement changes to revenue recognition
- Implement changes to lease accounting
- Identify impact of newly issued standards on your organization

Revenue Recognition

Revenue from Contracts with Customers (Topic 606)

Objective: To develop a single, principle-based revenue standard for generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS)

The revenue standard aims to improve accounting for contracts with customers by:

- Providing a robust framework for addressing revenue issues as they arise
- Increasing comparability across industries and capital markets
- Requiring better disclosure

Substantially converged with IFRS on major provisions

Revenue Recognition—Scope

All contracts with customers, except

- × Lease contracts
- × Insurance contracts
- × Financial instruments
- × Guarantees
- × Nonmonetary exchanges in the same line of business to facilitate sales to customers

Contracts not with customers are excluded:

- Contributions
- Collaborative arrangements

Revenue Recognition—Model

- Core Principle:

> **Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services**

- Steps to apply the core principle:

1. **Identify contract(s) with the customer**
2. **Identify performance obligations**
3. **Determine transaction price**
4. **Allocate transaction price**
5. **Recognize revenue when (or as) a performance obligation is satisfied**

Revenue Recognition—Disclosures

Disaggregation of revenue

- Qualitative and quantitative* disaggregation of revenue into **categories** that depict how revenue and cash flows are affected by economic factors

Information about contract balances

- Opening and closing balances *
- Amount of revenue recognized from contract liabilities *
- Explanation of significant changes in contract balances *

Remaining performance obligations

- Transaction price allocated to remaining performance obligations *
- Quantitative or qualitative explanation of when amounts will be recognized as revenue *

Interim requirements

- Quantitative disclosures *

* for public entities only

Revenue Recognition—Effective Date

Original effective dates

– **CY 2017** (FY 2017-18) for **public entities*** (including interim)
– **CY 2018** (FY 2018-19) for **nonpublic entities** (no interim, just annual period; interims in subsequent years)
– Nonpublic entities may adopt early, but no earlier than public entities

Deferred effective dates

- **CY 2018** (FY 2018-19) for **public entities*** (including interim)
- **CY 2019** (FY 2019-20) for **nonpublic entities** (no interim, just annual period; interims in subsequent years)
- Early adoption permitted, but not before original effective date

* Public entities include NFPs with publicly traded conduit (or direct) debt

Rev. Rec. – Some Areas of Focus for NFPs Discussed by AICPA Task Forces

Contributions

- TRG: not in scope
- Grants: referred to FASB (see following slides)

Tuition and Fees

Membership Dues

Health Care: various issues, including:

- Self-pay patients
- Medicare/Medicaid payments (and subsequent audits)
- Continuing Care Retirement Communities: entrance fees and other issues

License and Royalty

License and Royalty

- Example - The University participates in significant NCAA division 1 sporting events. A commercial company obtains the license to use the University's name and logos. The commercial company manufactures various items such as clothing, hats and memorabilia on which is plans to affix the University's name and logos. For these rights, the University receives $500,000 at the execution of a contract. The University will also receive a royalty of 1% of the sales price of any products using the University's name and logos. The term of the contract is 4 years.

License and Royalty

Step 1
- University receives consideration for allowing the company to use its logos.

Step 2
- The University will continue to participate in athletics and maintain excellence in educational services. These activities do not directly transfer a good or service to the commercial company and therefore only one performance obligation is identified; the granting a license to the commercial company.

Step 3
- The transaction price includes both fixed and variable consideration. The fixed component is the upfront payment of $500,000 upon the execution of the contract. The variable consideration is the royalty of 1% of future sales on items containing the University's name or logo.

Step 4
- As noted in step 3, there is only one performance obligation. Therefore the entire transaction price is allocated to that performance obligation.

License and Royalty

- Topic 606 defines two types of intellectual property;

1. Functional
   - ◊ Characteristics of standalone functionality.
   - ◊ Recognize revenue at a point in time.
2. Symbolic
   - ◊ No standalone functionality.
   - ◊ Value is derived from past and or ongoing activities.
   - ◊ Recognize revenue over time.

License and Royalty

Step 5

- IP determined to be symbolic. Value is derived from past and ongoing activities. Absent those activities logos would have no value.
- Recognize revenue over term of contract.
- Royalty component – recognize revenue only when or as the latter of 1) sale occurs or 2) performance obl. has been partially satisfied.

Annual Dues

Education and Advocacy Membership

An NFP has annual dues of $200 and the only benefit members receive is a monthly newsletter with a fair value of $50.

- ✓ Step 1: Identify the contract.
- ✓ Step 2: Identify the performance obligation(s).
- ✓ Step 3: Determine the transaction price.
- ✓ Step 4: Allocate the transaction price to the performance obligation(s).
- ✓ Step 5: Recognize revenue as each performance obligation is satisfied

Education and Advocacy Membership (continued)

- ✓ Step 1: Identify the contract.

  Amount paid ($50) for the newsletter is contract with a customer since this is a reciprocal transaction. The remaining $150 is a contribution since, no specific identifiable benefits are provided.

- ✓ Step 2: Identify the performance obligation(s).

  The NFP has a obligation to provide the monthly newsletter to the member in return for the payment.

- ✓ Step 3: Determine the transaction price.

  The FV of the newsletter ($50) is the transaction price.

- ✓ Step 4: Allocate the transaction price to the performance obligation(s).

  $50 is allocated to the performance obligation to provide the monthly news letter.

- ✓ Step 5: Recognize revenue as each performance obligation is satisfied

  $50 is recognized as revenue over 12 months as each issue is provided to the member. Remaining $150 is recognized as contribution revenue as received.

Naming Rights

Naming Rights

- Example - A University receives $13,000,000 from a corporation. In exchange for the payment the University agrees to name its new basketball stadium in the corporation's name. That name must be prominently displayed on the front of the stadium to specific specifications contained within an agreement between the University and the corporation. The stadium is located next to a heavily traveled road in the heart of the city where the University is located. The term of the agreement is 15 years.

Naming Rights

Step 1
- The contract is deemed to have commercial substance as corp. is receiving value (advertising).

Step 2
- One performance obligation – naming right and signage in accordance with the terms of the contract.

Step 3
- Transaction price is $13,000,000.

Step 4
- Entire transaction price is allocated to single performance obligation.

Step 5
- University concludes that corp. simultaneously receives and consumes benefits over contract term.
- Recognize revenue ratably over 15 years.

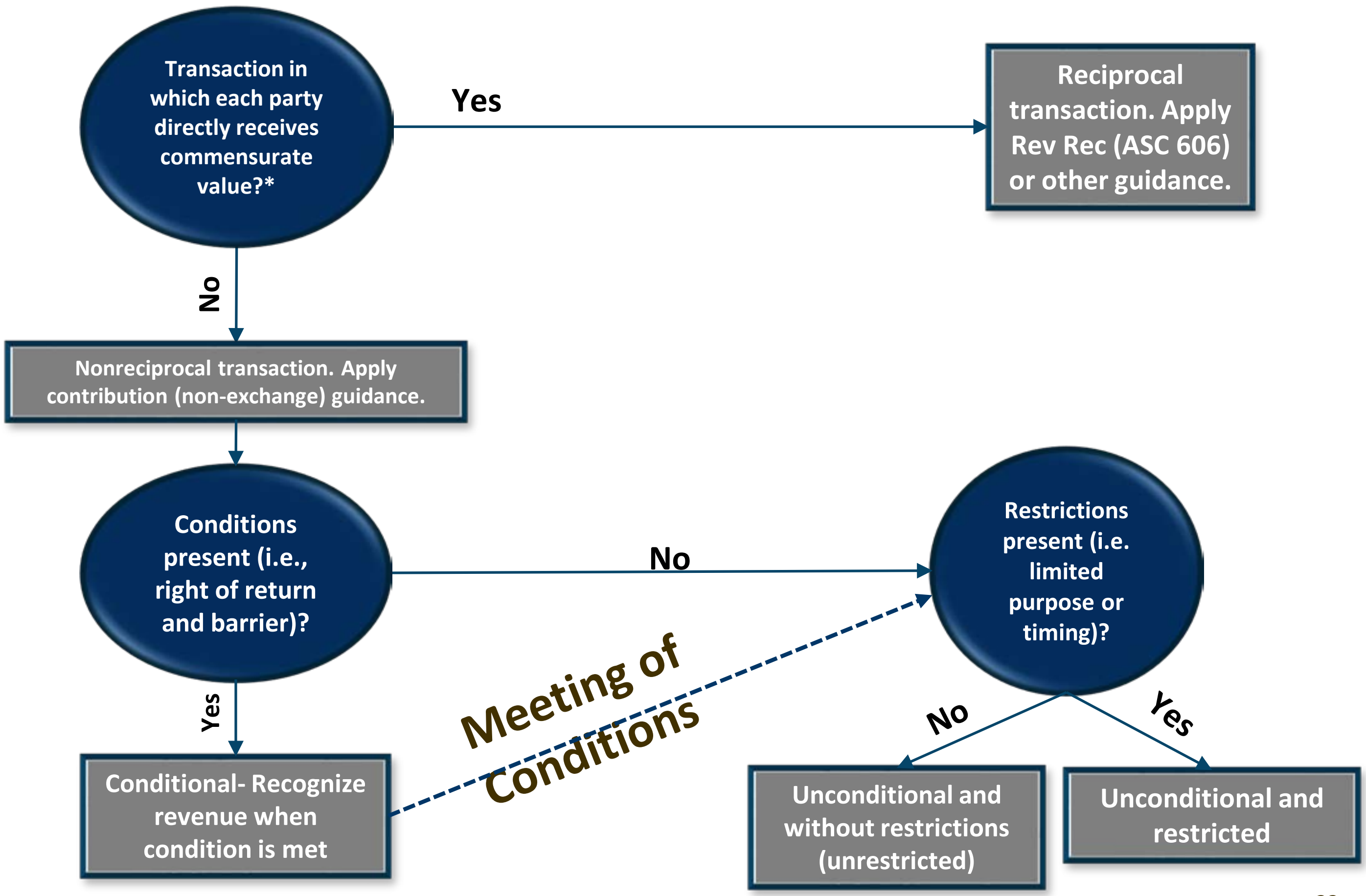
Revenue Recognition

How many have started determining the impact?

Will this be a major change in recognition?

Timeline of the Project

NFP Revenue Recognition Decision Process



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

Grants & Contracts

How many of you see this as a change?

Mindset or accounting?

Leases

ASU No. 2016-02
What is a Lease?

A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

We have a lease…now what?

- Under ASC 842, virtually all leases will require balance sheet recognition as a right-of use (ROU) asset and lease liability.
- Lease classification will impact the amount and timing of lease income and expense.
  - Operating
  - Finance

Balance Sheet

Finance Lease

- Record a right-of-use asset and a lease liability

Operating Lease

- Record a right-of-use asset and a lease liability

Income Statement

Finance Lease

- Interest expense using the effective interest method.
- Amortization is recorded on the right-of-use asset
- The periodic expense at the beginning of the lease term will generally be greater than the corresponding cash payments, but will decline over the lease term as the lease liability is reduced

Operating Lease

- Total lease expense is recorded on a straight-line over the lease term: add interest expense (effective interest method) plus amortization of the ROU asset.
- Unlike a finance lease, amortization of the ROU asset is calculated as the difference between the straight-line expense and the interest expense on the lease liability for a given period

Income Statement

Finance Lease

- Interest and amortization expense should generally be presented separately in the income statement
- The right-of-use asset is tested for impairment in accordance with ASC 360

Operating Lease

- Lease expense is presented as a single line item in operating expense in the income statement
- The right-of-use asset is tested for impairment in accordance with ASC 360

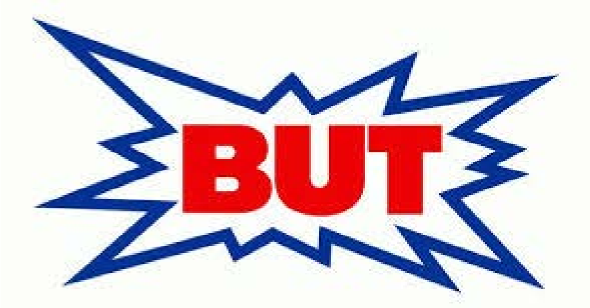
Lease Classification

- Financing lease if ANY of the following 5 conditions are met:
  - Transfer of ownership
  - Option to purchase is reasonably certain
  - Lease term is a major part of the economic life
  - Present value of lease payments is substantially all of the fair value of the underlying asset
  - The underlying asset is of a specialized nature

- If none of the above are met, the lease is operating

Lease Classification: Implementation Guidance

- The ASU eliminates the bright-line rules:
  - Lease term is for 75 percent or more of the economic life of the asset
  - Present value of the lease payments (including any guaranteed residual value) is at least 90 percent of the FV of the leased asset.
- Implementation guidance indicates entities may use thresholds similar to those they currently use
- Therefore, practice may not be significantly altered



Components within a lease

- Lease accounting applied at the lowest component.
- After determining the lease and nonlease components, a reporting entity should consider whether the lease contains more than one lease component.
- Must identify the ***units of account***.

Examples of nonlease components

- Property taxes and insurance
- Common area maintenance (CAM) of leased office space, such as cleaning and landscape services
- Lease of specialized equipment to a hospital, a medical device supplier may also provide operational or maintenance services

Transition and Disclosures

- Modified retrospective approach
- Must recognize ROU Asset & Liability
- Practical Expedients
  - Identification
  - Classification
  - Use of hindsight

Qualitative Lessee Disclosures

- Nature of leases Terms and conditions of sale-leaseback transactions
- **Information about leases not yet commenced**
- Leases between related parties
- **Significant assumptions and judgments**
- **Short-term lease exemption policy**
- Use of practical expedient

Quantitative Lessee Disclosures

- Finance, Operating, Short-term and Variable lease costs
- **Supplemental noncash info on lease liabilities from obtaining ROU assets**
- Sublease income
- **Weighted average remaining lease term and discount rate**
- Net gains (losses) on sale-leaseback transactions
- 5-year Maturity analysis
- **Cash paid for amounts included in measurement of lease liabilities**

Effective Date

- Public Entities: Fiscal years beginning after December 15, 2018, including interim periods within those fiscal years
- All Other: Fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020
- Early application permitted

Other recently issued ASUs impacting NFPs

ASU 2016-07 Investments – Equity Method and Joint Ventures

- Eliminates requirement to retroactively adjust accounting treatment for investment
- Equity method on date qualifies for equity method
  - Change in ownership
  - Change in level of influence
- Effective 12/31/17, early application is permitted

ASU No. 2016-13, *Financial Instruments—Credit Losses* (Topic 326*): Measurement of Credit Losses on Financial Instruments*

Contributions (pledges) receivable are excluded

Trade receivables and student loans (and other programmatic loans) receivable are included

CECL model not expected to result in significant impact on most NFPs

- Likely already taking CECL considerations into account for their trade and loan receivables

More noteworthy is the change for Available-for-Sale Debt Securities (healthcare NFPs): now an allowance approach

Effective for CY 2021 (FY 2021-22)

Key Provisions of ASU No. 2016-14 (Phase 1)

Liquidity & Availability

Quantitative and qualitative disclosures about liquidity and availability of resources

Net Asset Classification

Updates net asset classification scheme to two classes, changes to underwater endowment accounting, enhances disclosures

Expenses

Requirement to report expenses by function (already required) and nature, and an analysis showing the relationship between function and nature

Statement of Cash Flows

Continue to allow direct or indirect method for operating cash flows; indirect reconciliation no longer required for direct method

Investment Return

Present investment return net of external and direct internal investment expenses, no longer required to disclose netted expenses

Effective Date: Fiscal years beginning after 12/15/2017

Restricted Cash (ASU 2016-18)

Requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents

Does not provide a definition of restricted cash or restricted cash equivalents

Includes restricted cash and restricted cash equivalents in the beginning and ending totals of the cash flow statement

Requires entities to disclose the line items and amounts of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents reported within the statement of financial position

ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)*

1. Debt prepayment or extinguishment costs
2. Settlement of zero-coupon bonds
3. Contingent consideration payments made after a business combination
4. Proceeds from the settlement of insurance claims
5. Proceeds from the settlement of life settlement contracts
6. Distributions received from equity method investees
7. Beneficial interests in securitization transactions
8. Application of the predominance principle

ASU 2017-02 NFP Consolidation

- Per ASU 2015-02:
  - Limited Partnerships now assessed as VIE's
  - VIE accounting is not applicable to NFP's
  - Effective 12/31/2017
- FASB re-deliberated impact on NFP's
  - Consolidation still required for GP
- Effective fiscal years beginning after December 15, 2016
  - 12/31/2017 or 6/30/2018
  - Early adoption permitted
  - Retroactive application

Improving the Presentation of Net Periodic Pension Cost & Net Periodic Postretirement Benefit Cost—ASU No. 2017-07

Background

- Net benefit cost contains several components with different nature
- No GAAP guidance on presentation
- Reduced predictive value and usefulness of information to users
- Board added project

Presentation of net benefit cost in the income statement (retrospective application)

- Service cost in the same line item or items as other current employee compensation costs
- Remaining components in a separate line item or items outside operating items, if applicable

Capitalization of only service cost in assets (prospective application)

ASU No. 2017-07 is effective December 15, 2017 for public business entities and December 15, 2018 for other entities

ASUs Effective for 6/30/2017

Simplifying Debt Issue Costs (ASU 2015-03)

- Requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability
- Requires amortization using effective interest method with expense classified as interest expense (vs. amortization expense)

Going Concern (ASU 2014-15)

- Moves the Guidance from Audit (AICPA) to Accounting (FASB)
- Requires management to evaluate
- Significant focus on disclosure

Other Recent ASUs

Clarifying the Definition of a Business (ASU 2017-01)	• Provides a more robust framework to determine when a set of assets and activities is a business and more consistency in applying the guidance, reducing application costs, and increasing operability in practice
Clarifying When a Not-for-Profit Entity That is a General Partner Should Consolidate a For-Profit Limited Partnership (or Similar Entity) (ASU 2017-02)	• Clarifies when a NFP entity that is a general or limited partner should consolidate a for-profit limited partnership or similar legal entity by reinstating the presumption of control by the general partner of a limited partnership
Accounting for Goodwill Impairment (ASU 2017-04)	• Changes the test for goodwill impairment to a one-step quantitative impairment test whereby a goodwill impairment loss is measured as the excess of a reporting unit's carrying amount over its fair value

Any Questions?

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