Changes in Nonprofit Financial Statements

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Disclaimers

The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the user. The user also is cautioned that this material may not be applicable to, or suitable for, the user's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The user should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the user of any changes in tax laws or other factors that could affect the information contained herein.

Housekeeping

- If you are experiencing technical difficulties, please dial: 800-422-3623.
- Q&A session will be held at the end of the presentation.
  - Your questions can be submitted via the Questions Function at any time during the presentation.
- The PowerPoint presentation, as well as the webinar recording, will be sent to you within the next 10 business days.
- For future webinar invitations, subscribe at CLAconnect.com/subscribe.
- Please complete our online survey.

CPE Requirements

- Answer the polling questions

- If you are participating in a group, complete the CPE sign-in sheet and return within two business days
  - Contact webmaster@CLAconnect.com

- Allow four weeks for receipt of your certificate; it will be sent to you via email

* *This webinar, once recorded, has not been developed into a self study course. Therefore, watching the recording will not qualify for CPE credit.*

About CliftonLarsonAllen

- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 4,500 employees
- Offices coast to coast
- Over 60 years of experience, serving more than 6,000 nonprofit clients

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

Speaker Introductions

Cathy Clarke, Chief Assurance Officer

- More than 20 years of experience.
- Experience in conducting training sessions for audit and accounting staff within CliftonLarsonAllen and for the American Institute of CPAs.
- Current member of FASB's Not for Profit Advisory Committee

Learning Objectives

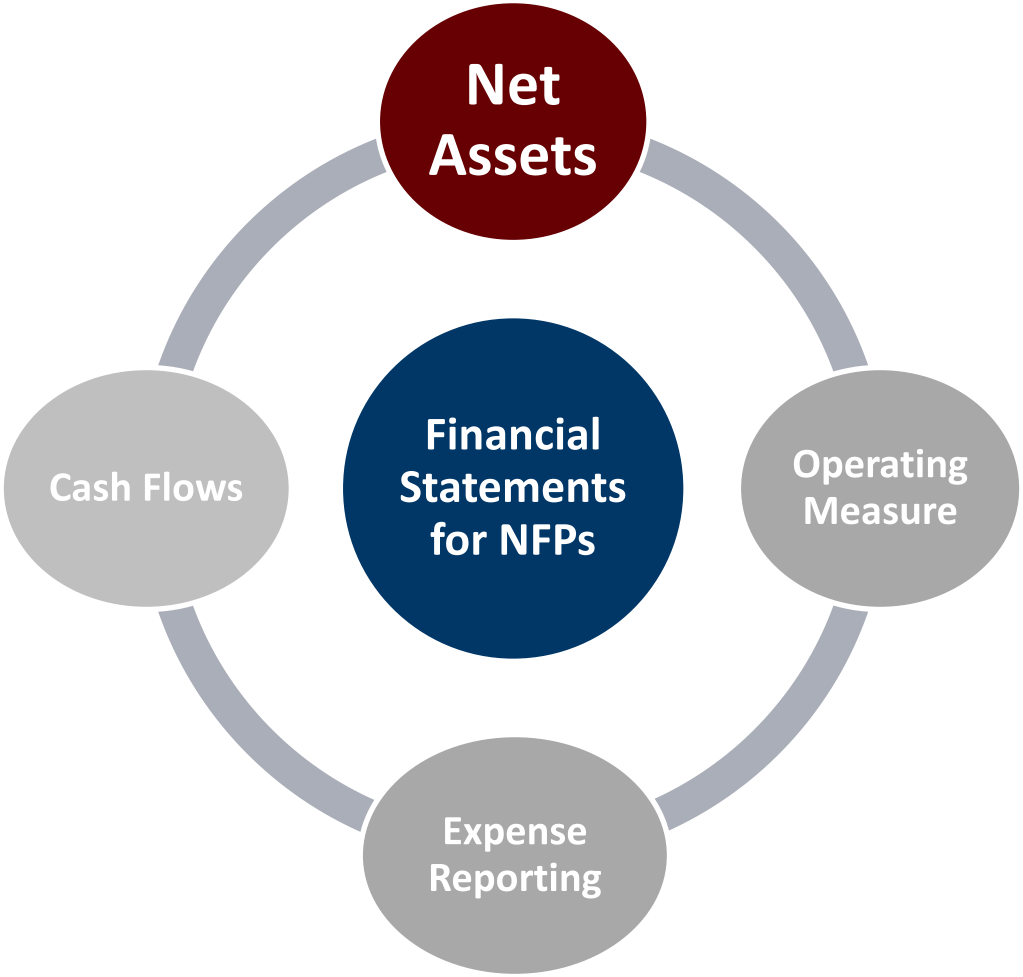
- At the end of this session, you will be able to:
  - Describe the new and pending FASB statements
  - Explain the pending changes to the Not for Profit Reporting model
  - Show understanding of updated Revenue Recognition and Leases Standards

Not-for-Profit Reporting Model

Not for Profit Report Model Standard

- Addressing four issues:
  1. Net Asset classification complexities
  2. Inconsistencies in reporting operating measure
     - Liquidity
     - Financial performance
  3. Inconsistencies in expense reporting
  4. Misunderstanding of statement of cash flows
- Proposed effective date: fiscal years beginning after December 15, 2017 (12/31/18 or 6/30/19)

Current FASB Projects



Two Net Asset Classes

Current Presentation	Unrestricted	Temporarily Restricted	Permanently Restricted
Proposed Presentation	Without “Donor” Restrictions	With “Donor” Restrictions	

Net Asset Classification Requirement

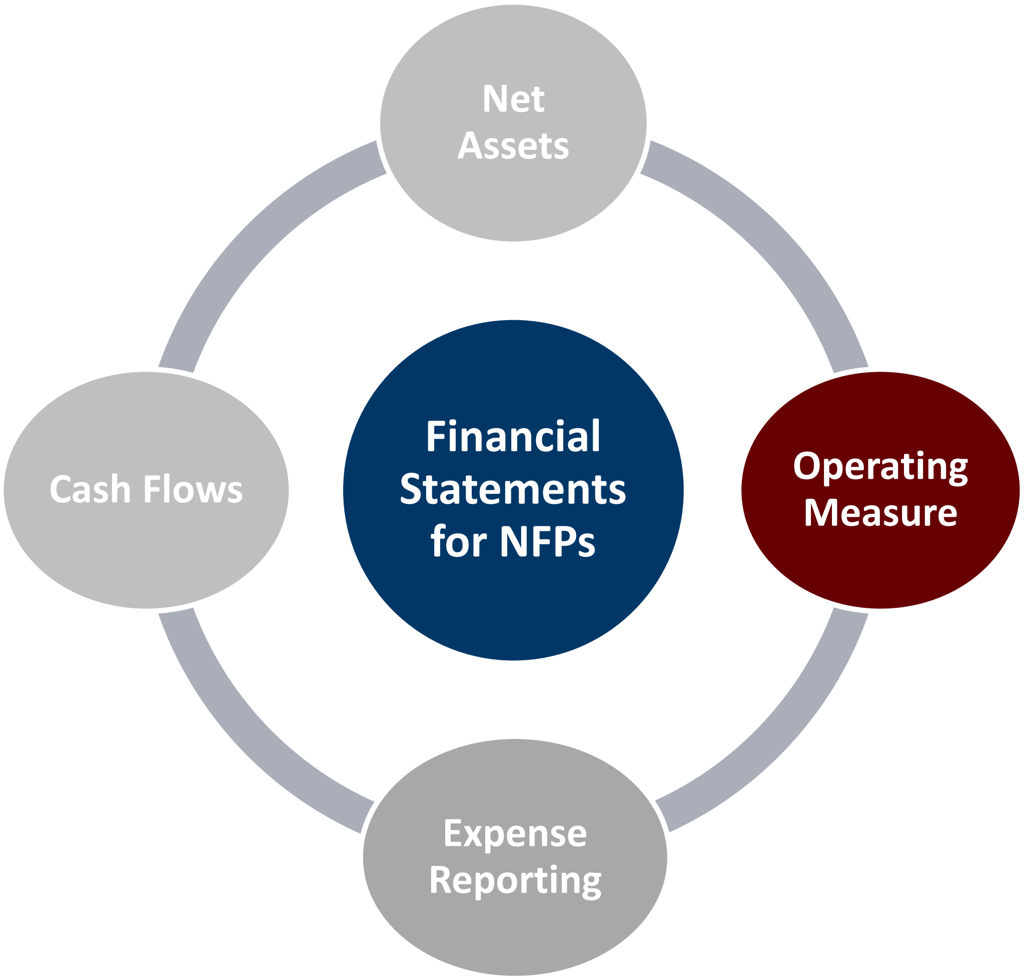
- Two classes
  - *Donor-imposed restrictions*
    - *Includes perpetual and temporary*
  - *Without donor-imposed restrictions*
    - *Includes board designated*
- Disclosure requirement:
  - Emphasis on how/when resources (net assets) can be used.
    - Specified purpose
    - Specified time
    - Perpetual (endowment)
  - Purposes of board designations.

Underwater Endowments

- Reported within "with donor restrictions" class of net assets.

- Disclose
  - Policy to spend from underwater funds
  - Original gift of underwater funds (in aggregate)
  - Fair value of underwater funds (in aggregate)

Current FASB Projects



Financial Performance – Intermediate Operating Measure

- Presentation will remain optional.
  - Additional disclosures required
  - If transfers between operating and non operating exist, required to disclose nature and amount in notes
- Performance Indicator in Health Care Entities – No change

Liquidity

Qualitative

- Define time horizon used to manage liquidity (30, 60, 90 days)
- Information on HOW manage liquidity (cash reserves, line of credit)

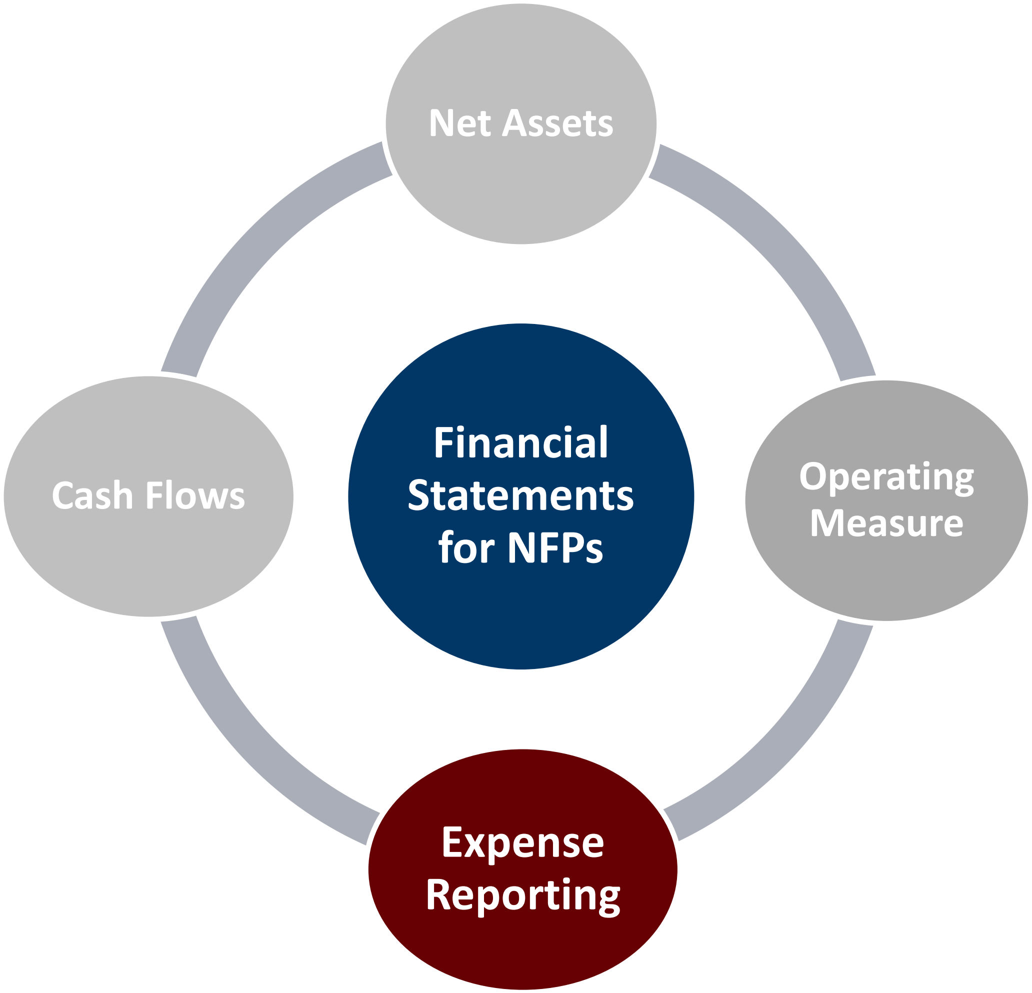
Quantitative

- Total Financial Assets
- Restrictions on financial assets
- Total financial liabilities
- Annual Only
- Could be covered on statements

Investment Return

- Net presentation of investment expenses against investment return.
  - Both EXTERNAL and direct INTERNAL expenses
  - Removes requirement to disclose the gross investment income and expense
  - Disclosure of which internal expenses are included

Current FASB Projects



Expense Analysis

- Present an analysis of expenses by function and nature in one location (in the notes, in the statement of activities, or as a separate statement)
- Include a description of the method used to allocate costs among program and support functions
- Only operating expenses required to be functionalized
- Investment expenses netted against investment returns may be excluded
- Voluntary Health and Welfare entities no longer required to present a separate statement of functional expenses
- Still debating “business like” NFP requirement

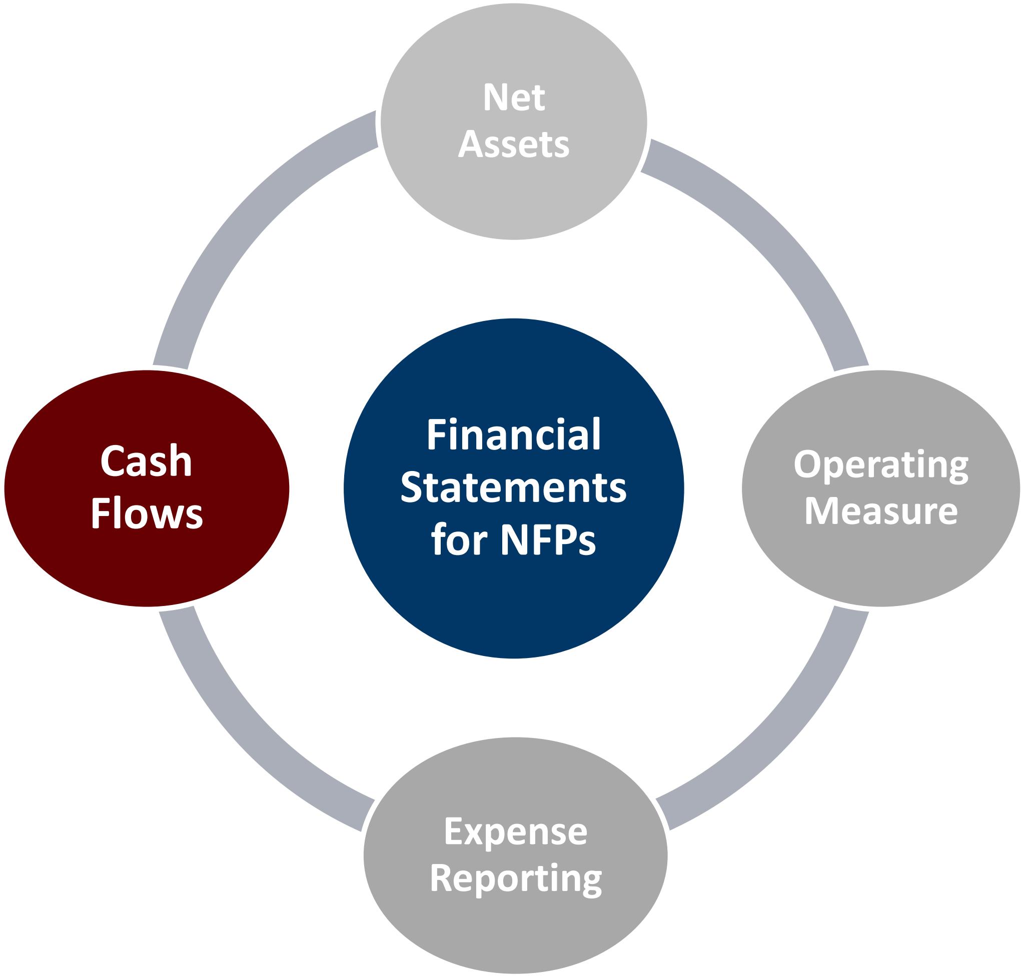
Analysis of Expenses

The table below presents operating expenses by both their nature and function for fiscal year 20X1. Internal salaries and benefits that have been netted against investment returns amount to $375 and are excluded from the salaries and benefits information presented below.

	Program Activities			Supporting Activities				
	A	B	C	Management and General	Fund-Raising	Operating Expense	Nonoperating Expense	Total Expenses
Salaries and benefits	$ 7,400	$ 3,900	$ 1,725	$ 1,130	$ 960	$ 15,115		$ 15,115
Grants to other organizations	2,075	750	1,925			4,750		4,750
Supplies and travel	865	1,000	490	240	560	3,155		3,155
Services and professional fees	160	1,490	600	200	390	2,840		2,840
Office and occupancy	1,160	600	450	218	100	2,528		2,528
Depreciation	1,440	800	570	250	140	3,200		3,200
Interest							$ 382	382
Total expenses	$ 13,100	$ 8,540	$ 5,760	$ 2,038	$ 2,150	$ 31,588	$ 382	$ 31,970

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation and office and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits, which are allocated on the basis of time and effort studies.

Current FASB Projects



Cash Flow Statement

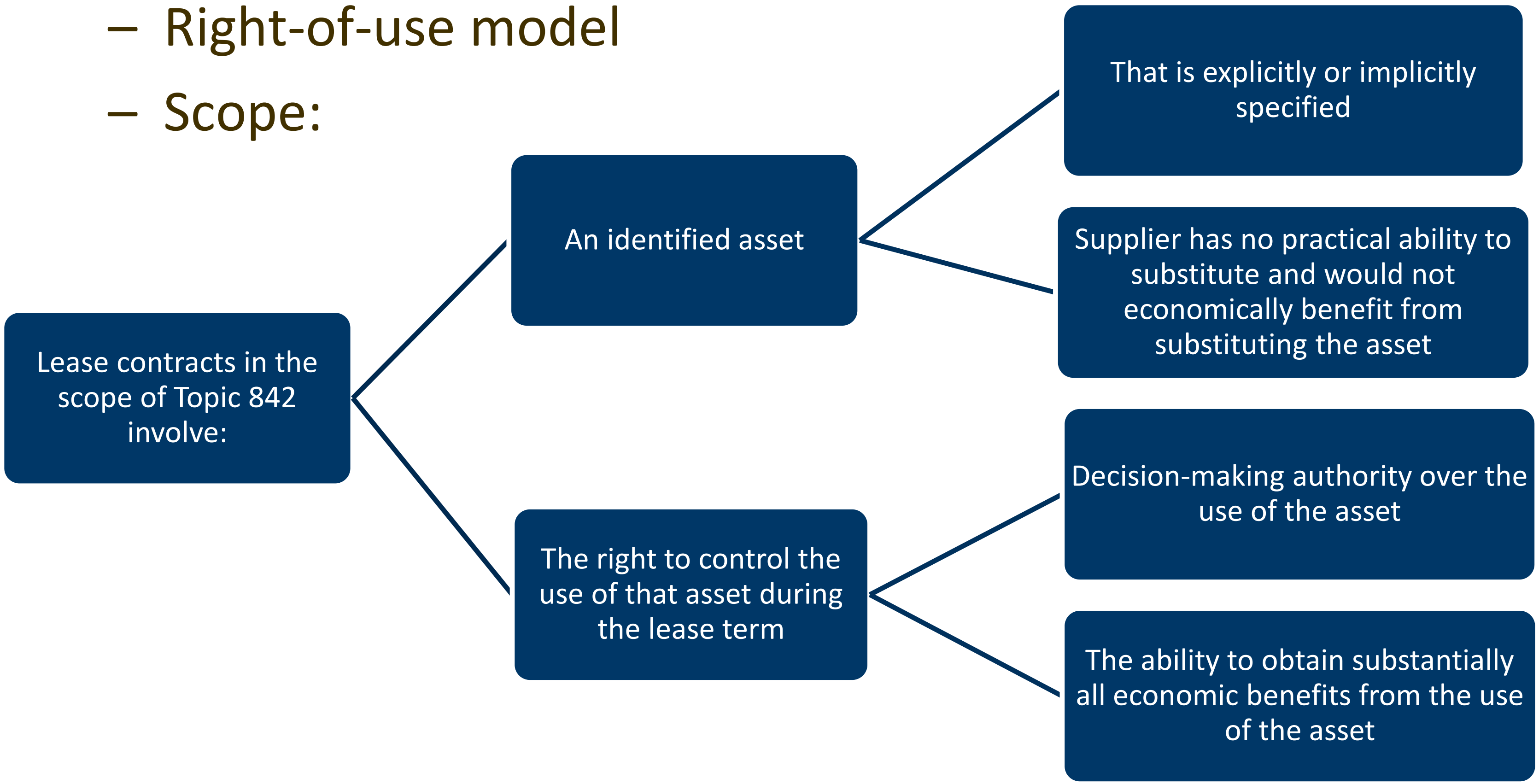
- Can continue to use either direct or indirect method
- If use direct, no longer required to show indirect reconciliation
- Other proposed changes deferred

Leases

Lease Accounting

ASU 2016-02 issued February 25, 2016

- Right-of-use model
- Scope:



Lessee Accounting Model

	Balance Sheet	Income Statement	Cash Flow Statement
Finance	Right-of-use asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payment
Operating	Right-of-use asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payment

Classification criteria substantially similar to that in previous lease guidance

Private companies may use risk-free rates when measuring present value of lease liabilities

Effect of leases on the statements of income and cash flows largely unchanged

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

Lessor Accounting Model

	Balance Sheet	Income Statement	Cash Flow Statement
Sales-type & Direct Financing	Net investment in the lease	Interest income and any selling profit on lease	Cash received for lease payments
Operating	Continue to recognize the underlying asset	Lease income	Cash received for lease payments

Lessor accounting is largely unchanged

Classification criteria substantially similar to that in previous lease guidance

Lease Accounting

- Short-term leases – lessee may make an accounting policy election by class of underlying asset not to recognize lease assets and liabilities when the lease term is 12 months or less
- Optional periods – recognize only if reasonably certain to exercise the option (same for purchase options)
- Leveraged leases – those commencing before the effective date are grandfathered

Lease Accounting

- Effective Date:
  - Public entities (including NFP with conduit debt)– 12/31/19 or 6/30/20
  - Nonpublic entities – 12/31/20 or 6/30/21
  - Early adoption permitted for all entities
  - Transition – recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach
    - A number of practical expedients are available

Revenue Recognition

Revenue Recognition – Effective Date

ASU 2015-14 extended the effective date

- One year extension for public and private entities
- ASU making the extension official is expected to be issued soon

Effective for reporting periods beginning on or after:

- December 15, 2017 for public companies (incl conduit debt)
  - December 31, 2018/June 30, 2019
- December 15, 2018 for private companies and not-for-profit organizations
  - December 31, 2019/June 30, 2020
- Early implementation permitted for annual periods beginning after December 15, 2016 (the original public company effective date)

Revenue Recognition (Topic 606)

Objective: To develop a single, principle-based revenue standard for US GAAP and IFRS

– 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

Final U.S. GAAP Model – Scope

- All contracts with customers, <u>except</u>
  - ✘ Lease contracts
  - ✘ Insurance contracts
  - ✘ Financial instruments
  - ✘ Guarantees
  - ✘ Non-monetary exchanges in the same line of business to facilitate sales to customers
- Certain contracts not with customers are <u>excluded</u>:
  - Contributions
  - Collaborative arrangements

Final U.S. GAAP Model – Recognition

Recognize revenue to depict the transfer of goods or services in an amount that reflects the consideration to which the entity expects to be entitled

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

Major Changes in Comparison to Current Guidance

- Focus is on the contract rather than on transactions of certain types or by certain industries
- Constraint on revenue
- Licenses
- Recognition and measurement guidance applies to transfers/sales of nonfinancial assets to non-customers
- Guidance on accounting for costs to obtain and fulfill a contract with a customer (if not addressed in other topics)
- Disclosures

Final U.S. GAAP Model – Disclosure

Disaggregation of revenue	• Disaggregate 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	• All quantitative disclosures in annual and interim *(public entities only)*

Potential Application Considerations for Not-for-Profits and Health Care Entities

- Membership Dues
- Tuition and Fees
- Licenses and Royalties
- CCRC's
- Bifurcation
- Governmental Grants and Contracts
- Other Issues Identified

Practical Steps for Implementing ASC 606

1. Read the Standard and all relevant commentary from audit firms – attend related CPE

2. Assign individual staff to become subject matter experts on specific revenue categories or by section to lead a group of staff to understand and implement the new standard. Include relevant staff outside of accounting: internal audit, legal, etc.

Practical Steps for Implementing ASC 606

3. Compile a list of all organizational revenues, e.g.

- Membership Dues
- Patient Fees
- Entrance fees
- Royalties
- Advertising Revenue
- Sponsorship Revenue
- Federal, State, or Private Grants
- Investment Income
- Contributions
- Retail Sales
- Educational Service Fees
- Pass-Through Funds
- Tuition
- Fee for Service
- Refunds
- Miscellaneous
- For-Profit Affiliate Revenues

Practical Steps for Implementing ASC 606

4. Develop and document a position paper on each revenue stream
   - Read the standard
   - Document your current process (if applicable)
   - Identify the relevant sections, being as specific as possible when options are presented
   - Support your position with facts, including facts as to why a specific section may not be applicable
   - Document your conclusion on how to recognize revenue
   - Review with your external auditor
   - Finalize and approve new recognition policy

5. Consider discussing issues with similar organizations within your industry

6. If a change is required, is it material?
   - If no, document, discuss impact with auditors (annual passed adjustment?) and continue with prior recognition methodology

Practical Steps for Implementing ASC 606

7. If a change in recognition is required, consider impact on the following:
   - Are changes in verbiage needed for new related contracts?
   - Recognition processes within the accounting system
   - Technical changes within the accounting or supporting systems
   - Monthly/annual financial close process
   - Internal financial reporting
   - Audited financial statements
   - Forecast and budget processes
   - Dashboard goals
8. Communicate changes to CFO, Board, audit/finance committee, senior staff, key programmatic stakeholders, auditors, internal auditors, contract signers, banks, bondholders, etc.
9. Determine requirements to retrospectively adopt the new standard or prepare comparative financial statements (prior year restatement?)
10. Develop a plan for staff training

New Requirements Issued by FASB

Effective Date Pending

Updated through 5/18/2016

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 2016-01 Financial Instruments

- Eliminates distinction between trading and AFS
  - Equity investments at FV w/changes to income
  - Impact on HC Performance Indicator presentation
- Remove disclosure requirement for FV of financial instruments measured at amortized cost (i.e. FV debt) *can early adopt this provision now
- Effective 12/31/19 or 6/30/20
  - Early adoption as of 12/31/18

ASU 2015-16 Business Combination

- Provisional amounts
  - Accounting incomplete at end of the reporting period in which the combination occurs
- Measurement period adjust provisional amounts
- Recognize adjustments that are identified during the measurement period in the reporting period in which the adjustment amounts are determined
- Effective 12/31/17 or 6/30/18
  - Early adoption is allowed
  - Prospective adoption

ASU 2015-11 Inventory

- Current: Inventory = Lower of Cost or Market
  - Market = Replacement Cost, Net Realizable Value or NRV less normal profit margin
- New: Inventory = Lower of Cost or NRV
  - NRV = Estimated selling price, less reasonably predictable costs of completion, disposal, and transportation
- Effective 12/31/18 or 6/30/19
- Early adoption is allowed
  - Prospective adoption

ASU 2015-07 Fair Value Measurement Disclosures for Investments…that calculate NAV

- NAV investments excluded from FV hierarchy
- Disclose still required
  - Redemption restrictions
  - Unfunded commitments
- Effective 12/31/17 or 6/30/18
  - Early adoption is allowed

ASU 2015-05 Accounting for Cloud Computing Costs

- If agreement contains software license:
  - Accounting is consistent with acquisition of software
  - Contractual right to take possession of the software at any time during the hosting period without significant penalty
  - Feasible to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software
- If agreement does NOT contain software license
  - Accounting is consistent with service contract
- Effective: Fiscal years beginning after December 15, 2015 (early adoption permitted)

ASU 2015-03 Simplifying Debt Issue Costs

- Simplifying the Presentation of Debt Issuance Costs
  - 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
  - Moves unamortized financing costs from an asset to a reduction of debt, similar to how bond premium/discounts are already presented today.
  - Effective for fiscal years beginning after December 15, 2015. (December 31, 2016/June 30, 2017).
  - Early adoption is allowed.
  - ASU 2015-15 issued to address LOC treatment

ASU 2015-02 Consolidation

- Limited Partnerships now VIE's
- VIE accounting is not applicable to NFP's
- Could result in deconsolidation
  - Re-evaluate LP's to determine if control (> 50% voting interest) or change to equity method
- Effective date:
  - 12/31/2017
  - Early implementation is allowed
- Adoption method : Full Retrospective

ASU 2014- 15 Going Concern

- Moves guidance from Audit to Accounting
- Management evaluates
- Significant focus on disclosure
- Requires substantial doubt consideration and disclosure
- Effective date:
  - Periods ending after December 15, 2016
  - Early adoption is permitted

ASU 2014-08 Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

- Discontinued Operations may include
  - A component of an entity
  - A group of components of an entity
  - A business or nonprofit activity
- Strategic shift that has major effect on entity's operations
  - Disposal of major geographical area
  - Major line of business
  - Major equity method investment
  - Effective after December 15, 2015

Questions?

Cathy Clarke

cathy.clarke@CLAconnect.com

To receive future webinar invitations, subscribe at CLAconnect.com/Nonprofit/