

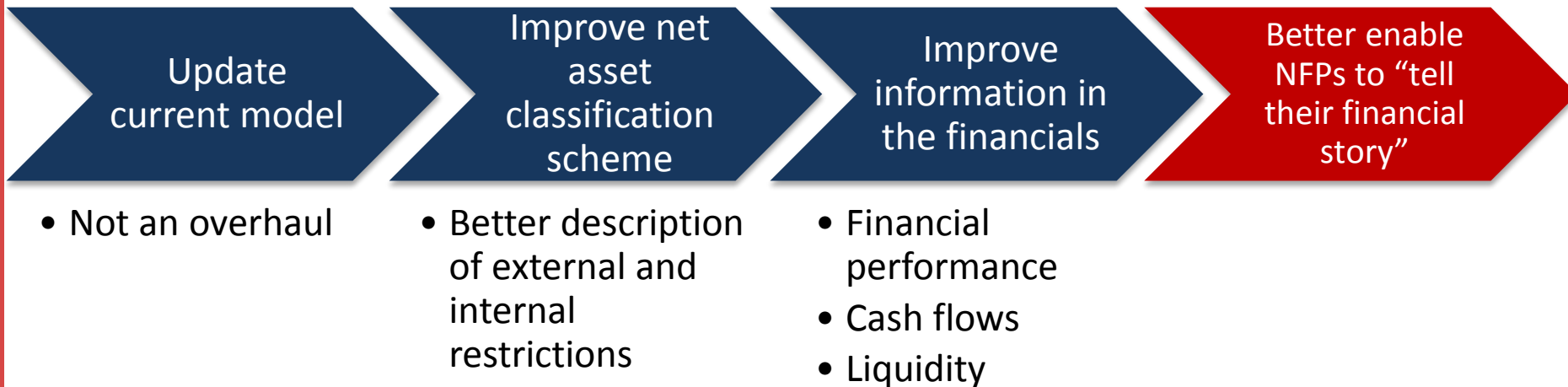
Accounting Deep Dive Part 1

The New Not-for-Profit Reporting Model

WA/AK HFMA Annual Trade Fair and Conference
September 22, 2016

Background

- FASB's Not-for-Profit Advisory Committee ("NAC")
- Studied areas for improving GAAP for NFPs
- *Project Objectives:*



FASB Proposed Changes



- Exposure Draft issued
 - *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954) – Presentation of Financial Statements of Not-for-Profit Entities*
 - Issued April 2015; lots of feedback to FASB in 2015
 - CN participated by submitting a comment letter from firm and sending a representative to FASB Roundtable

FASB Proposed Changes (Continued)

- Results of feedback
 - FASB has split the proposal in two phases
 - Phase 1: Issued Accounting Standard Update (ASU) No. 2016-14 in August 2016, Effective for fiscal years beginning after December 15, 2017. Early application of the amendments in the ASU is permitted.
 - Amendments should be applied on a retrospective basis in the year the ASU is first applied. However the analysis of expenses by both natural classification and functional classification (unless previously required for the type of entity) and the new disclosures about liquidity and availability of resources may be omitted for any periods presented before the period of adoption.
 - In the period the amendments are first applied, an NFP should disclose the nature of any reclassification or restatements and their effects, if any, on changes in the net asset classes for each period presented.

Key Changes in ASU

Net asset
classification

Board
designated net
assets

Liquidity
disclosures

Expense
disclosures

Releasing
restrictions for
donated PP&E

Investment
income &
expenses

Underwater
endowments

Presentation of
statement of
cash flows

Operating
measure
disclosures

Net Asset Classification

- 3 classes of net assets reduced to 2
 - Temporarily and permanently restricted net assets combined into single classification:
 - ***Net Assets with Donor Restrictions***
 - Unrestricted net assets renamed:
 - ***Net Assets without Donor Restrictions***
- Continue to comply with existing disclosure requirement:
 - Nature and amount of donor restrictions on net assets

Examples

Net assets:

Without donor restrictions	92,677
With donor restrictions	<u>145,407</u>
Total net assets	<u><u>238,084</u></u>

Summary presented on
face of Balance Sheet

Details in footnotes; or
presented on face of
Balance Sheet

Net assets:

Without donor restrictions	92,677
With donor restrictions -	
Time restricted pledges receivable	25,000
Scholarships	8,250
Children's program	10,000
Endowment fund	<u>102,157</u>
	<u>145,407</u>
Total net assets	<u><u>238,084</u></u>

Board Designated Net Assets

- Required to disclose amounts and purposes of board-designated net assets
 - GAAP current allows disclosure but does not require
- Disclose either on the face of financials or in the notes
- Examples:
 - Quasi-endowments
 - Liquidity reserves
 - PP&E replacement funds

Examples

Net assets without donor restrictions:

Undesignated	56,377
Quasi-endowment	35,000
Operating reserve	<u>1,300</u>
Total net assets	<u><u>92,677</u></u>

Tabular disclosure or on face

Text
disclosure in
notes

Note 13 - Net Assets Without Donor Restrictions

The Board of Directors of XYZ Organization has several standing board policies that affect the presentation of board designations on net assets. Bequests without donor restrictions are designated for long-term investment (quasi-endowment). The quasi-endowment fund balance totaled \$35,000 at December 31, 20XX. Additionally, the Board of Directors has established an operating reserve with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need. The operating reserve balance totaled \$1,300 at December 31, 20XX.

Liquidity Disclosures

- **Qualitative** information on how a NFP manages its liquid resources available to meet cash needs for general expenditures within 1 year of the balance sheet date (*in the notes*)
- **Quantitative** information that communicates the availability of current financial assets at the balance sheet date to meet cash needs for general expenditures within 1 year of the balance sheet date (*on the face of the financials and/or in the notes*)
 - Availability may be affected by -
 - Nature of the assets
 - External limits imposed by donors, laws, contracts, etc.;
 - Internal limits imposed by board decisions

Example 1

Note 5 – Information about Liquidity

The Organization manages its liquidity by maintaining adequate working capital, setting aside funds in an operating reserve, and maintaining an available line of credit with a bank.

The Organization maintains cash in its operating bank accounts in sufficient amounts to ensure employee and vendor payments can be made in a timely manner and to accommodate seasonal changes in cash inflows and outflows. The following table calculates the Organization's working capital balance at June 30, modified for amounts that are internally designated or externally restricted for specific purposes.

	<u>20X2</u>	<u>20X1</u>
Current assets	\$ 12,048	\$ 11,610
Less amounts that are internally designated or externally restricted:		
Internal Board designations	(2,745)	(2,798)
External contractual restrictions	(449)	(453)
Modified current assets	8,854	8,359
Current liabilities	(5,868)	(5,909)
Modified working capital	<u>\$ 2,986</u>	<u>\$ 2,450</u>

Example 1 - continued

Note 5 – Continued

The Organization has an operating reserve that had a balance of \$2.7 million and \$2.8 million at June 30, 2015 and 2014, respectively. This is a governing board-designated reserve with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. The Organization's target for this reserve is a total of \$3.0 million, which was determined based on management's judgment about the appropriate amount of funds to have set aside in addition to working capital. The operating reserve funds are held in lower-risk cash and fixed-income securities. The operating reserve balance is included in the cash and cash equivalents and investment lines on the statement of financial position (2015 - \$1.0M in cash and cash equivalents and \$1.7M in investments; 2014 - \$1.1M in cash and cash equivalents and \$1.7M in investments). In the event of an unanticipated liquidity need, the Organization also could draw upon \$2,500,000 of an available line of credit (as further discussed in Note 8).

Example 2

Note 5 – Information about Liquidity

The Organization manages its liquidity by maintaining adequate working capital, setting aside funds in an operating reserve, and maintaining an available line of credit with a bank.

The following table shows a determination of the Organization's financial assets that are available to meet cash needs for general expenditures within one year.

	<u>20X2</u>	<u>20X1</u>
Cash and cash equivalents	\$ 2,476	\$ 2,685
Investments	5,436	5,149
Accounts receivable	4,136	3,776
Total financial assets	<u>12,048</u>	<u>11,610</u>
Less amounts that are internally designated or externally restricted:		
Internal Board designations	(2,745)	(2,798)
External contractual restrictions	(449)	(453)
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 8,854</u>	<u>\$ 8,359</u>

Expense Disclosures

- All NFPs required to present a Statement of Functional Expense, or equivalent
 - Expenses disclosed by both their nature and function
 - All expenses (except netted investment expenses) presented by nature and function in one location
 - Separate statement (e.g., Statement of Functional Expenses)
 - Notes
 - Face of the Statement of Activities
 - Show relationship between functional and natural categories by disaggregating functional by natural
- Must disclose method(s) used to allocate costs among program and support functions

Example

Note 5 - 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 the benefit received, and the information technology department is allocated based on a cost study of specific technology utilized.

Releasing Restrictions for Donated PP&E



- Releasing restrictions on donated PP&E and contributions restricted to acquire PP&E
- Current approaches:
 - When money is spent
 - When property placed in service
 - Ratably over useful life of property
- New approach:
 - When property is placed in service (this is not new for healthcare entities)

Investment Income and Expenses



- Must report investment income net of:
 - External investment expenses
 - Direct internal investment expenses
 - *Previously, a NFP could opt to report investment expenses netted with investment income or at gross with other expenses*
- Disclosures that are no longer required:
 - Investment expenses that are netted against investment income
 - Investment return components in the endowment net asset rollforward

Example Format 1

Revenue	\$X,XXX
Expenses	XXX
Excess of revenues over expenses	<u>XXX</u>
Investment return, net	<u>XXX</u>
Less:	
Unrealized gains (losses) on other than trading debt securities excluded from performance indicator	<u>(200)</u>
Performance indicator	<u>XXX</u>
Add:	
Unrealized gains (losses) on other than trading debt securities excluded from performance indicator	<u>200</u>
Change in net assets without donor restrictions	<u>\$XXX</u>

Example Format 2

Revenue	\$X,XXX
Expenses	<u>XXX</u>
Excess of revenues over expenses	<u>XXX</u>
Investment return, net, excluding unrealized gains (losses) on debt securities (other than trading)	XXX
Performance indicator	<u>XXX</u>
Unrealized gains (losses) on other than trading debt securities excluded from performance indicator	<u>200</u>
Change in net assets without donor restrictions	<u><u>\$XXX</u></u>

Underwater Endowment Funds



- Report entire balance in “net assets with donor restrictions”
- Disclosures for endowment funds that are underwater
 - NFP’s policy to either reduce expenditure or not spend from underwater endowment funds
 - The aggregate fair value of the fund(s)
 - The aggregate original endowment gift amount or level required by donor stipulation or by law to be maintained for the fund(s)
 - The aggregate of the amount of the deficiencies of the fund(s)

Statement of Cash Flows



- Current GAAP:
 - Allowed to use either the Indirect Method or the Direct Method for presenting operating cash flows
 - If use the Direct Method, then must also show Indirect
- New:
 - No longer required to present Indirect Method if the Direct Method is used

Operations Measure Presented in the Statement of Activities




- Some NFPs choose to present an intermediate measure of operations in the statement of activities and show **governing board designations, appropriations, and similar actions** (*internal transfers*) in the measure
- These NFPs must report these types of internal transfers appropriately **disaggregated and described by type** (either in the face of the financials or in the notes)

- Phase 2 topics to be addressed in the future:
 - Require NFPs to report an intermediate measure of operations on the statement of activities
 - Reformat the statement of cash flows to align with the intermediate measure of operations

What Should You Do Now?



- Review process and documentation of **governing board designations**; update as necessary
- Review **methodology used to allocate expenses** to functional categories for reasonableness; update as necessary
- Continue (*or start*) regular discussions with the governing board on how the NFP manages **liquidity and liquidity risk**

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- Clark Nuber Newsletters and Blogs
 - Future HFMA Conferences
 - NFP Accounting & Tax Update Seminar – Fall 2017
 - Client workshops on implementing the new ASU – TBD in 2018
 - Lots of information at AICPA NFP and Healthcare Conferences

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