

# 2018 Tax Update for Exempt Organizations

---

Prepare for Change



# Unrelated Business Income (UBI)

# Unrelated Business Income (UBI)

Taxed under  
corporate tax law  
— except trusts

*Goal: Preventing nonprofits from  
having an unfair advantage over  
for-profit businesses*

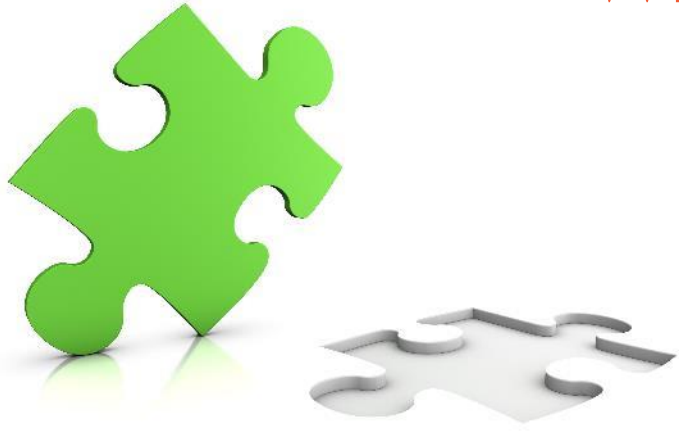


## What defines UBI?

- Trade or business
- Regularly carried on
- Not substantially related to the purpose of the organization



## What is excluded?



- Work done by volunteers
- For the convenience of members, students, patients or employees
- Selling donated merchandise
- Certain bingo games

## Deductions on Form 990-T must:

- Have a **proximate and primary relationship**
- Allocate expenses between exempt and non-exempt activities on a “**reasonable basis**”  
*Note: “Safe harbor” allocation model has been promised for years, but is not yet published*
- Claim net operating losses **consistently with corporate** tax law



# Changes in UBI Rules

# Changes in UBI Rules



- New 21% tax rate (blended rate for fiscal year 2018)
- Silo approach to claiming losses
  - Calculate each trade or business separately
  - May carry forward losses, but not offset income from another business



# Changes in UBI Rules



- How does IRS define a separate trade or business?
- How can expenses be allocated among separate businesses?

# Interim Guidance



## Released August 21, 2018 — Notice 2018-67

- What is a trade or business? Use NAICS 6-digit codes
- Special rules for partnership interests
  - *De minimis* test
  - Control test
  - Aggregating partnership interests
- Transition rule for interests acquired before August 21, 2018

# Changes in UBI Rules

## Net Operating Losses (NOL)

- Can deduct NOLs from tax years that began **before January 1, 2018**
- Years beginning on or after Jan. 1, 2018 — no carryback period, but losses can be carried forward indefinitely
- Deduction is limited to 80% of taxable income

# Interim Guidance



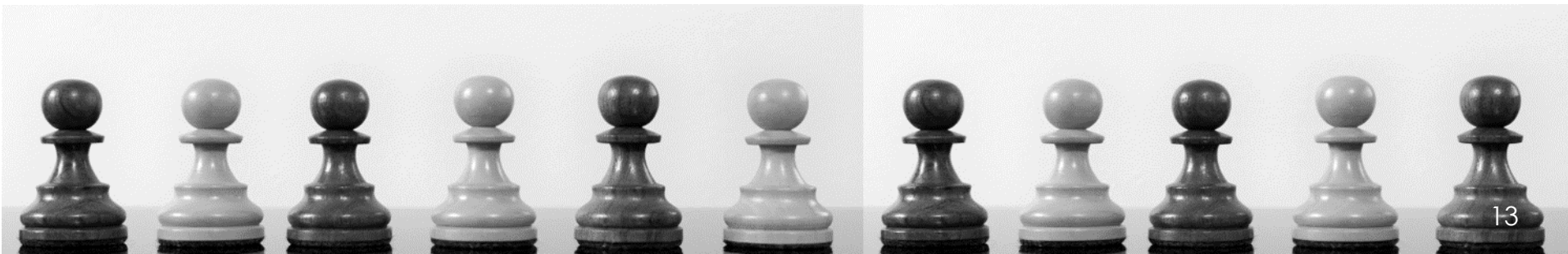
**Released August 21, 2018 — Notice 2018-67**

- Net Operating Losses
  - Claim silo losses first, then pre-Tax Act loss carryovers
  - No guidance on how the 80% of taxable income limitation applies
  - What if a pre-Tax Act NOL is about to expire?

# Changes in UBI Rules

## Fringe Benefit Rules — Mass Transit Passes and Parking

- For-profit businesses can no longer deduct their employees' non-taxable mass transit pass or parking benefits (Section 274)
- For tax-exempt organizations, expenses incurred as of Jan. 1, 2018, for mass transit passes and employee parking will be UBI





# Changes in UBI Rules



- Parking provided in a facility you own — is the employee portion of upkeep costs UBI?
- What if visitors must pay to use the facility?
- What if you have free spaces under your office lease?

These issues are *not* on the  
IRS Priority Guidance Plan.

# Changes in UBI Rules



## Planning Options

- Make estimated tax payments and file returns based on your best guess as to what income should be
- Include your best estimate of the value of this benefit in the employee's W-2



# Changes in UBI Rules



Our recommendation:  
The organization pays the tax. Why?

- If valuation is wrong, you have to amend numerous W-2s
- Employees **under** the FICA limit: Payroll tax costs alone will be 15.3% compared to the 21% UBI cost
- Employees **over** the FICA limit: Their marginal tax rate is likely more than 21%

The background of the slide is a close-up photograph of numerous light-colored wooden blocks. One block, positioned slightly to the left of the center, is painted a vibrant red. The blocks are arranged in a way that suggests they might be part of a larger structure or a game, with some blocks standing upright and others lying flat. The lighting is soft, creating gentle shadows and highlighting the natural texture of the wood.

# **21% Excise Tax on Executive Compensation**

# 21% Excise Tax on Executive Compensation

## Imposed on "covered employees"

- Any current or former employee who is:
  - One of the five highest paid employees for the tax year
- OR
- Was a covered employee of the organization, or any predecessor, for any tax year beginning after Dec. 31, 2016

AND...





# 21% Excise Tax on Executive Compensation

## Applies to "applicable tax-exempt organizations"

- All 501(b) and 501(c) organizations
- Local government agencies, except political subdivisions — agencies that have taxing authority, police power or right of eminent domain
- Farmers' cooperatives
- 527(e)(1) political organizations

**AND...**



# 21% Excise Tax on Executive Compensation

Employee receives either:

- "Remuneration"  $\geq$  \$1 million
  - Includes any payment by a related person or government entity
  - Does not include fees for medical or veterinary services performed by licensed professionals

OR...



# 21% Excise Tax on Executive Compensation

## “Excess parachute payments”

- Contingent on separation
- Aggregate present value equals or exceeds three times the base compensation
- Exceptions:
  - Benefit payments under a qualified plan
  - Annuity contracts under 403(b) or 457(b) plans
  - Payments to licensed doctors or veterinarians for medical services they perform
  - Payments to someone who is not a highly compensated employee





# Final Charitable Contribution Substantiation Regulations



# Final Charitable Contribution Substantiation Regulations



- Giving a donor a blank pledge card to complete is not sufficient substantiation
- Giving the donor a fully completed Form 8283 is not sufficient substantiation

*Thank you!*

We appreciate  
your attention  
and hope this  
information  
has been  
helpful.



Discussion

Contact us:

**Laura McNutt**

Of Counsel

Direct: 210.572.3720

Email: [laura.mcnutt@weaver.com](mailto:laura.mcnutt@weaver.com)

# Nonprofit Accounting & Audit Update

---

September 13, 2018



# OVERVIEW OF UPCOMING CHANGES



# Upcoming Changes



## ASU 2016-14

Presentation of Financial Statements of Not-for-Profit Entities

### Summary:

An update to the current net asset classifications and the information presented in financial statements and notes about liquidity, financial performance and cash flows.

### Effective Date:

Fiscal years beginning **after December 15, 2017** (calendar YE '18 and fiscal YE '19)

## ASU 2014-09

Revenue from Contracts with Customers

### Summary:

An update to clarify the principles for recognizing revenue, remove inconsistencies, improve comparability and usefulness and to simplify financial statement preparation.

### Effective Date:

Fiscal years beginning **after December 15, 2017** (calendar YE '18 and fiscal YE '19)

## ASU 2018-08

Clarifying the Scope & Guidance for Contributions Received & Made

### Summary:

An update to improve the scope and accounting guidance for

- contributions vs exchange transactions
- determining if a contribution is conditional

### Effective Date:

Fiscal years beginning **after December 15, 2018** (calendar YE '19 and fiscal YE '20)



# Upcoming Changes

## ASU 2016-02

### Leases

#### Summary:

An update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities and disclosing key information about leasing arrangements.

#### Effective Date:

Fiscal years beginning **after December 15, 2019** (calendar YE '20 and fiscal YE '21)





# ASU 2016-14: Presentation of Financial Statements of Not-for-Profit Entities



# ASU 2016-14: Presentation of Financial Statements of Not-for-Profit Entities

- ✓ Net asset classifications reduced from three to two
- ✓ Must report expenses by nature & function and describe the methods used to allocate among functional categories
- ✓ New liquidity and availability disclosures required
- ✓ Underwater endowments - accumulated losses to be included together with the related fund in net assets with donor restrictions.
- ✓ Net investment return - investment expenses shall be netted against investment return and reported in the related net asset category
- ✓ No longer require the presentation or disclosure of the indirect method reconciliation if using the direct method.

# Net Asset Classification

## Current GAAP

- Unrestricted
- Temporarily Restricted
- Permanently Restricted

## New GAAP

- Without Donor Restrictions
- With Donor Restrictions

### Net Assets **without** donor restrictions:

- Management, the board or other governing body may not restrict funds
- Includes board designated endowments

### Net Assets **with** donor restrictions:

- Time restricted for future use
- Purpose restrictions
  - a particular activity
  - acquisition of long lived assets
- Endowment established by a donor

# Net Asset Classification – Statement of Financial Position



## Not-for-Profit Entity A Statement of Financial Position June 30, 20XX

	20XX
Assets:	
Cash	\$ 4,575
Accounts and interest receivable	2,130
Inventories	610
Contributions receivable	3,025
Short-term investments	1,400
Assets restricted to investment in prc	5,210
Land, buildings, and equipment	61,700
Long-term investments	218,070
Total assets	<u>\$ 296,720</u>
Liabilities and net assets:	
Accounts payable	\$ 2,570
Grants payable	875
Annuity trust obligations	1,685
Long-term debt	5,500
Total liabilities	<u>10,630</u>
Net assets:	
Without donor restrictions	92,677
With donor restrictions	193,413
Total net assets	<u>286,090</u>
Total liabilities and net assets	<u>\$ 296,720</u>

### Net assets:

Without donor restrictions	92,677
With donor restrictions	193,413
Total net assets	<u>286,090</u>
Total liabilities and net assets	<u>\$ 296,720</u>

- At a minimum, two net asset classifications must be presented on the face of the financial statements, if applicable.
- Disaggregation of Net Assets without Donor Restrictions and Net Assets with Donor Restrictions is allowed

# Net Asset Classification – Statement of Financial Position



## Not-for-Profit Entity A Statement of Financial Position June 30, 20XX

	20XX
Assets:	
Cash	\$ 4,575
Accounts and interest receivable	2,130
Inventories	610
Contributions receivable	3,025
Short-term investments	1,400
Assets restricted to investment in property	5,210
Land, buildings, and equipment	61,700
Long-term investments	218,070
Total assets	<u>\$ 296,720</u>
Liabilities and net assets:	
Accounts payable	\$ 2,570
Grants payable	875
Annuity trust obligations	1,685
Long-term debt	5,500
Total liabilities	<u>10,630</u>
Net assets:	
Without donor restrictions	
Undesignated	42,677
Board designated for capital improvements	50,000
	<u>92,677</u>
With donor restrictions	
Time restricted for future purposes	20,000
Purpose restricted for programs	85,000
Donor endowment fund	88,413
	<u>193,413</u>
Total net assets	<u>286,090</u>
Total liabilities and net assets	<u><u>\$ 296,720</u></u>

Net assets:	
Without donor restrictions	
Undesignated	42,677
Board designated for capital improvements	50,000
	<u>92,677</u>
With donor restrictions	
Time restricted for future purposes	20,000
Purpose restricted for programs	85,000
Donor endowment fund	88,413
	<u>193,413</u>
Total net assets	<u>286,090</u>
Total liabilities and net assets	<u><u>\$ 296,720</u></u>

# Net Asset Classification – Statement of Activities



	Without Donor Restriction	With Donor Restriction	Total
<b>REVENUES</b>			
Contributions	\$ 102,089	\$ 201,993	\$ 304,082
Oil and gas royalties	546,187	-	546,187
Property rentals	281,403	-	281,403
Interest and dividends	1,012,688	54,162	1,066,850
Net unrealized and realized gain (loss) on investment securities	4,506,658	231,286	4,737,944
Net assets released from restrictions Satisfaction of program restrictions	45,830	(45,830)	-
<b>Total revenues</b>	6,494,855	441,611	6,936,466
<b>EXPENSES</b>			
Contributions Expense	2,251,116	-	2,251,116
Wages and benefits	288,480	-	288,480
Office expense	115,766	-	115,766
Ad valorem taxes	26,456	-	26,456
Fundraising	3,829	-	3,829
Other	64,821	-	64,821
<b>Total expenses</b>	2,750,468	-	2,750,468
<b>Change in net assets</b>	3,744,387	441,611	4,185,938
<b>NET ASSETS, beginning of year</b>	52,961,687	2,409,081	55,370,768
<b>NET ASSETS, end of year</b>	\$ 56,706,074	\$ 2,850,692	\$ 59,556,706

# Net Asset Classification – Notes to the Financial Statements

## Net assets with donor restrictions:

Net assets with donor restrictions are restricted for the following purposes or periods as of June 30, 20XX:

### **Subject to expenditure for specific purpose:**

Program A activities:

Purchase of equipment	\$ 1,530
Research	2,128
Educational seminars and publications	760

Program B activities:

Disaster relief	1,120
Educational seminars and publications	1,079
	<hr/>
	6,617

### **Subject to passage of time:**

For periods after June 30, 20XX	3,140
---------------------------------	-------

Total net assets with donor restrictions	<u>\$ 9,757</u>
--	-----------------





# Net Asset Classification – Notes to the Financial Statements

## **Net assets without donor restrictions:**

NFP A's governing board has designated net assets without donor restrictions for the following purposes as of June 30, 20XX:

Quasi-endowment	\$ 34,658
Liquidity reserve	1,300
Total	<u><u>\$ 35,958</u></u>



# Net Asset Classification – Notes to the Financial Statements

## **Net assets released from restrictions:**

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of the passage of time or other events specified by donors as follows for the year ended June 30, 20XX:

### Purpose restrictions accomplished:

Program A expenses	\$ 15,800
Program B expenses	4,600
Program C expenses	<u>1,590</u>
	21,990

Program A equipment acquired and placed in service	1,500
---	-------

### Time restrictions expired:

Passage of specified time	850
Death of annuity beneficiary	<u>400</u>
	1,250

Release of appropriated endowment returns without purpose restrictions	<u>7,500</u>
---	--------------

Total restrictions released	<u><u>\$ 32,240</u></u>
-----------------------------	-------------------------



# Functional Expense Presentation

## Current GAAP

Schedule of functional expenses mandatory for health and welfare organizations and recommended, but not required, for other NFPs.



## New GAAP

Expenses reported by nature and function either in statement of activities, schedule of functional expenses or in notes for **all** NFPs.

This shall be presented in an analysis that disaggregates **functional expense classifications** by their **natural expense classifications**.

# Functional Expense Presentation

	PROGRAM SERVICES				Total Program Services
	Clubs	Program A	Program B	Program C	
<b>EXPENSES</b>					
Salaries	\$ 1,401,363	\$ 796,733	\$ 114,925	\$ 497,566	\$ 2,810,587
Employee benefits and payroll taxes	196,798	229,035	32,618	134,841	593,292
Total salaries and related expenses	1,598,161	1,025,768	147,543	632,407	3,403,879
<b>OTHER EXPENSES</b>					
Professional fees	92,730	64,697	14,059	11,357	182,843
Supplies and repairs	244,232	126,801	314,367	22,193	707,593
Telephone	33,837	29,626	-	9,440	72,903
Postage and shipping	1,132	386	579	192	2,289
Occupancy	73,232	100,075	10,725	-	184,032
Printing	3,680	37	-	74	3,791
Transportation	83,600	106,180	-	22,258	212,038
Donated resources	626,824	-	-	-	626,824
Miscellaneous		24	-	16	40
Affiliated organizations	20,701	-	-	-	20,701
Depreciation of property and equipment	266,255	-	-	-	266,255
Interest	-	-	-	-	-
Special events	-	-	-	-	-
Allocation of support services	-	-	-	-	-
Total other expenses	1,446,223	427,826	339,730	65,530	2,279,309
<b>TOTAL EXPENSES 2017</b>	<b>\$ 3,044,384</b>	<b>\$ 1,453,594</b>	<b>\$ 487,273</b>	<b>\$ 697,937</b>	<b>\$ 5,683,188</b>

# Functional Expense Presentation



	SUPPORTING SERVICES			TOTAL PROGRAM AND SUPPORTING SERVICES
	Management and General	Fundraising	Total Supporting Services	2017
<b>EXPENSES</b>				
Salaries	\$ 518,823	\$ 278,741	\$ 797,564	\$ 3,608,151
Employee benefits and payroll taxes	58,296	51,479	109,775	703,067
Total salaries and related expenses	577,119	330,220	907,339	4,311,218
<b>OTHER EXPENSES</b>				
Professional fees	24,174	23,331	47,505	230,348
Supplies and repairs	20,071	42,181	62,252	769,845
Telephone	16,243	6,929	23,172	96,075
Postage and shipping	4,220	4,184	8,404	10,693
Occupancy	27,871	-	27,871	211,903
Printing	64	5,047	5,111	8,902
Transportation	82,833	11,623	94,456	306,494
Donated resources	-	-	-	626,824
Miscellaneous	150	-	150	190
Affiliated organizations	-	-	-	20,701
Depreciation of property and equipment	16,790	-	16,790	283,045
Interest	3,884	-	3,884	3,884
Special events	-	83,359	83,359	83,359
Allocation of support services	(76,747)	-	(76,747)	(76,747)
Total other expenses	119,553	176,654	296,207	2,575,516
<b>TOTAL EXPENSES 2017</b>	<b>\$ 696,672</b>	<b>\$ 506,874</b>	<b>\$ 1,203,546</b>	<b>\$ 6,886,734</b>

# Functional Expense Presentation – Notes to the Financial Statements



**DISCLOSURE** - Expense analysis is required to be supplemented with enhanced disclosures about the allocation methods used to allocate costs among functions

## **Note X1: Methods Used for Allocation of Expenses from Management and General Activities**

*The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is **allocated based on square footage**, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are **allocated based on estimates of time and effort**, and the information technology department is **allocated based on estimates of time and costs of specific technology utilized**.*

# Liquidity

## Current GAAP

There is no requirement to disclose information about liquidity.



## New GAAP

Organizations must disclose how it manages its liquidity and availability both quantitatively and qualitatively.

**Liquidity:** Relates to the type of assets the Organization has and the maturity of those assets to meet current obligations.

**Availability:** Is it available for use? Are there donor imposed other external restrictions? Or even self-imposed limits?



# Liquidity – Example A

NFP A has \$395,000 of financial assets available within one year of the balance sheet date consisting of cash of \$75,000, contributions receivable of \$20,000, and short-term investments of \$300,000. None of the financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the balance sheet date. The contributions receivable are subject to time restrictions, but will be collected within one year. NFP A has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately \$275,000. As part of its liquidity management, NFP A invests cash in excess of daily requirements in various short-term investments including certificates of deposits and short-term treasury instruments. As more fully described in Note X, NFP A also has committed lines of credit in the amount of \$20,000, which it could draw upon in the event of an unanticipated liquidity need.

---

# Liquidity – Example B

As part of NFP A's liquidity management, it invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of \$20 million which it could draw upon. Additionally, NFP A has a quasi-endowment of \$33 million. Although NFP A does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation, amounts from its quasi-endowment could be made available if necessary. However, both quasi-endowment and donor endowment contain lock-up provisions that would reduce the total investments that could be made available.

NFP A's financial assets due within one year of the balance sheet date for general expenditures are as follows:

Cash and cash equivalents	\$ 4,575
Accounts and interest receivable	2,130
Contributions receivable	1,825
Short-term investments	1,400
Other investments appropriated for current use	1,650
	<u>\$ 11,580</u>

NFP A's endowment funds consist of donor endowment and quasi-endowment. Income from donor endowment is restricted for specific purposes and, therefore, is not available for general expenditure. The quasi-endowment has a spending rate of 5 percent. \$1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.

# Liquidity – Example C

As part of NFP A's liquidity management, it invests cash in excess of daily requirement in short-term investments. Occasionally, the Board designates a portion of any operating surplus to its liquidity reserve, which was \$1,300 as of June 30, 20XX. There is an established board-designated fund where the governing board has 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 of the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, NFP A also could draw upon \$10,000 of available lines of credit (as further discussed in Note XX) or its quasi-endowment fund.

The following reflects NFP A's financial assets as of the balance sheet date, including amounts not available within one year of the balance sheet date. Amounts not available include amounts set aside for long-term investing in the quasi-endowment that could be drawn upon if the governing board approves that action.

Financial assets, as of June 30, 20XX	\$ 229,200
Less:	
Contractual or donor-imposed restrictions making financial assets unavailable for general expenditure	(192,413)
Quasi-endowment fund, primarily for long-term investing	(34,628)
Amounts set aside for liquidity reserve	<u>(1,300)</u>
Financial assets available within one year to meet cash needs for general expenditures within one year	<u>\$ 859</u>

# Liquidity

Examples of limitations that may make financial assets <u>unavailable</u>		
Its nature	Financial assets not convertible to cash within next 12 months	Contribution receivables due > 1 year
		Accounts/Notes receivable due > 1 year
		Illiquid investments not redeemable within 1 year
External limits of donors, laws, contracts	Donor restrictions limiting availability	Endowment financial assets considered perpetually restricted
		Assets from unappropriated endowment earnings, beyond 1 year
		Restricted for programs in future years, beyond 1 year
		Trusts and life income funds
	Contracts or legal restrictions	Bond sinking funds
		State required annuity reserves
Internal limits imposed by governing board decisions	Financial assets designated for long-term investing	Quasi-endowments intended for long-term investment
		Annuity funds
		Donor advised funds
	Intended for future years	Designated to future construction or deferred maintenance expected beyond 1 year (or all assets intended for long-lived assets???)

# ASU 2014-09: Revenue from Contracts with Customers





# ASU 2014-09: Revenue from Contracts with Customers

## Summary:

The goal of ASU 2014-09 is to remove inconsistencies, improve comparability, increase usefulness to the users of the financial statements and to simplify financial statement preparation. In order to do so, an entity should 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 and services.

## Affects on Not-for-Profit Entities:

Contributions are **excluded** from the standard because a donor is not a customer.

Transactions that are part contribution, part exchange (e.g., special events and certain memberships) will need to be bifurcated and each element accounted for separately.

The most controversial issue involved how to apply the standard to government grants, which was addressed by the issuance of ASU 2018-08.

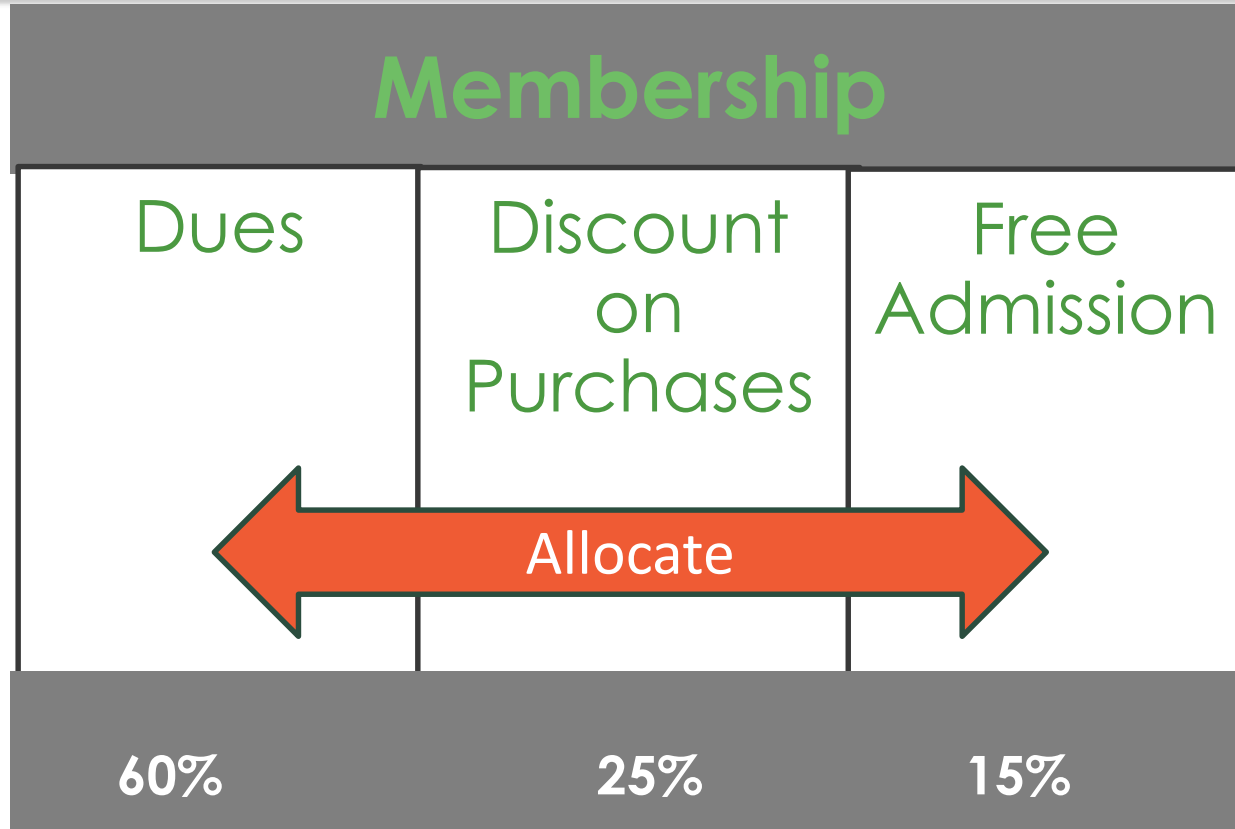
# ASU 2014-09: Revenue from Contracts with Customers

## New Five-Step Model:

1. Identify contract(s) with customer
2. Identify the performance obligation(s) in the contract
3. Determine the transaction price
4. Must **allocate** the transaction price to the performance obligation(s) in the contract
5. Recognize revenue as the Organization satisfies the obligation(s)



# ASU 2014-09: Revenue from Contracts with Customers



# ASU 2018-08: Clarifying the Scope and Guidance for Contributions Received and Contributions Made



# ASU 2018-08: Contributions

ASU 2018-08 was issued to clarify and improve the scope and the accounting guidance for contributions received and contributions made. The amendments in the update should assist entities in

- (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or as exchange (reciprocal) transactions subject to other guidance and
- (2) determining whether a contribution is conditional.





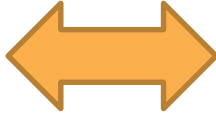
# ASU 2018-08: Contributions

## Contribution:

An **unconditional** transfer of cash or other assets, as well as unconditional promises to give, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

The resource provider often receives value **indirectly** by providing a societal benefit although that benefit is not considered to be of commensurate value.

Resource provider has full discretion over the amount transferred.



## Exchange Transaction:

A reciprocal transfer in which each party receives and sacrifices approximately commensurate value.

In an exchange transaction, the potential public benefits are secondary to the potential proprietary direct benefits to the resource provider.

# ASU 2018-08: Contributions



## **Conditional Contribution**

Must have both:

1. One or more barriers that must be overcome before a recipient is entitled to the assets transferred or promised.
2. A right of return to the contributor for assets transferred (or for a reduction, settlement, or cancellation of liabilities) or a right of release of the promisor from its obligation to transfer assets (or to reduce, settle, or cancel liabilities).

- An agreement does not need to include the specific phrase “right of return” but should be sufficiently clear to support a conclusion

- In cases of ambiguous donor stipulations, a contribution containing stipulations that are not clearly unconditional shall be presumed to be a conditional contribution

# ASU 2018-08: Contributions



After a contribution has been deemed not to have a donor imposed condition, an entity shall consider whether the contribution includes a donor imposed restriction.

A donor imposed restriction specifies a use for a contributed asset that is more specific than the following:

- a. The nature of the entity
- b. The environment in which it operates
- c. The purposes specified in its articles of incorporation or bylaws

May also be restricted for time

As a result of 2018-08, which clarified the definition of an exchange transaction NFPs will account for most federal grants as donor-restricted conditional contributions, rather than as exchange transactions and as such grants will be excluded from consideration within the scope of ASU 2014-09.

# ASU 2016-02: Leases



# ASU 2016-02: Leases

Lessees are now required to recognize a **lease liability** and a **right-of-use asset** for all leases (except short-term leases with a duration of **less than 12 months**) as of the commencement date (i.e. the date on which the lessor makes the underlying asset available to the lessee).



## Lease Liability

The lessee's obligation to make lease payments arising from a lease, measured on a discounted basis.



## Right-of-Use Asset

An asset that represents the lessee's right to use (or control the use of) a specified asset during the lease term.

## WHAT'S IN SCOPE?



### In Scope

- Leases of property, plant, and equipment

### Out of Scope

- Leases of intangible assets
- Leases of biological assets
- Leases of inventory
- Leases of assets under construction



## Lease Classification

The terms of a lease determine

- Classification
- Income statement recognition

### Financing Lease

- Lease effectively transfers control of the underlying asset
- Lease represents an in substance financed purchase (sale) of an asset
- Lease does not effectively transfer control of the underlying asset to the lessee, but the lessor obtains a guarantee for the value of the asset from a third party

All other leases are classified as **operating leases**.

# ASU 2016-02: Leases

## Measure the Initial Lease Liability

$$\begin{array}{|c|} \hline \text{Initial Lease Liability} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Present Value of Unpaid Future Lease Payments} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Present Value of amount probable of being owed under RVG} \\ \hline \end{array}$$

## Measure the Initial Right of Use Asset

$$\begin{array}{|c|} \hline \text{Initial Right of Use Asset} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Initial Lease Liability} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Initial Direct Costs} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Prepaid Lease Payments} \\ \hline \end{array} - \begin{array}{|c|} \hline \text{Lease Incentives Received} \\ \hline \end{array}$$

\* RVG = Residual Value Guarantee

# ASU 2016-02: Leases

Operating Lease (lease costs is determined on a straight-line basis)

$$\text{Lease Cost} = \frac{\text{Sum of Undiscounted Lease Payments for Lease Term} + \text{Initial Direct Costs} - \text{Incentives Received}}{\text{\# of Periods in Lease Term}}$$

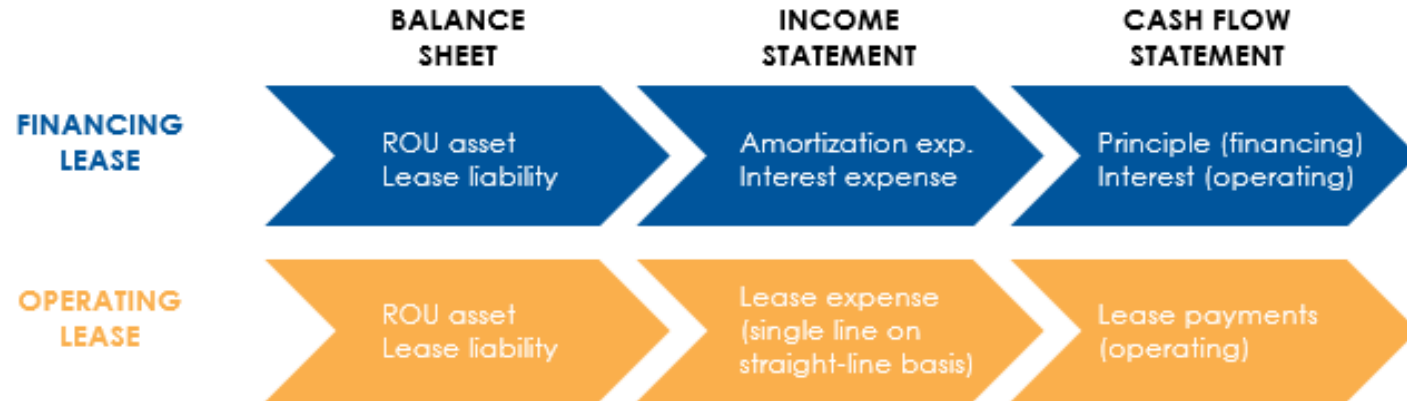
Finance Lease (Assuming straight-line amortization method)

$$\text{Amortization Expense} = \frac{\text{Initial Right of Use Asset}}{\text{\# of Periods in Lease Term}}$$

&

$$\text{Interest Expense} = \text{Initial Lease Liability} * \text{Interest Rate}$$

# ASU 2016-02: Leases



## LESSEE DISCLOSURES

- » Nature of its leases
- » Information about leases that have not yet commenced
- » Related-party lease transactions
- » Accounting policy election regarding short-term leases
- » Finance and operating lease costs
- » Short-term and variable lease costs
- » Sublease income
- » Gain or loss from sale-and-leaseback
- » Maturity analysis for lease obligations
- » Weighted-average remaining lease term
- » Weighted-average discount rate



## Let's Connect



@weavercpas

[facebook.com/weavercpas](https://facebook.com/weavercpas)

[linkedin.com/company/weavercpas](https://linkedin.com/company/weavercpas)

[youtube.com/weavercpas](https://youtube.com/weavercpas)

Insights blog – [weaver.com](https://weaver.com)

## Questions?

**Jackie Gonzalez, CPA**

Partner, Public Sector Assurance Services

[Jackie.Gonzalez@weaver.com](mailto:Jackie.Gonzalez@weaver.com)

817.882.7758