

How ASU 2016-14 Will Affect Your Not-for-Profit Entities

Part II: Net Asset Classification, Investment Earnings, Underwater Endowments and Cash Flows



Today's Presenters



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Learning Objectives

Upon completion of the ASU 2016-14 webinars, you will better understand:

- ▶ Goals of FASB changes
- ▶ Key components of the new standards
- ▶ Implementation timeline



Recap of ASU 2016-14

Timeline for Adoption



- ▶ Effective for financial statements for fiscal years beginning **after December 15, 2017** (i.e. calendar YE 2018 and fiscal YE 2019)
- ▶ **Early adoption is permitted**, subject to the designated transition method

Early Adoption



- ▶ For adoption year, all provisions apply retrospectively.
- ▶ For comparative financial statements, can choose to exclude the following for the prior year:
 - Disclosure/presentation of expenditures by nature and function
 - Certain liquidity disclosures and availability disclosures

WHAT IS IT?

- ▶ Update, **not** overhaul
- ▶ Largest update of NFP financial statements reporting model in **20+ years**
 - » Minor changes to measurement
 - » Mostly impacts **disclosures and presentation**
- ▶ Updates to **all three** financial statement types

Goals And Objectives

- ▶ Better enable NFPs to tell their financial story
- ▶ Better serve the needs of financial statement users
- ▶ Create clarity, uniformity and comparability in reporting across the financial statements of various NFPs
- ▶ Provide donors and lenders with liquidity information to better assess the financial health of the NFPs
- ▶ Improve net asset classification
- ▶ Improve information in financial statements and notes to the financial statements

Summary of the Changes



New liquidity and availability disclosures required

✓ Additional disclosures for underwater endowments

✓ Net asset classifications reduced from three to two

Must report expenses by nature & function and describe the methods used to allocate among functional categories

✓ Net investment return replaces other alternatives

✓ No longer require the presentation or disclosure of the indirect method reconciliation if using the direct method.

Let's Review

- At Not-for-Profit Fluffy Puppy, the CFO has the primary responsibility for
 - Accounting and reporting
 - Short-term budgeting and long-term financial planning
 - Cash management
 - Direct oversight of Fluffy Puppy's endowment

How should you allocate the CFO's compensation?

- A. Programs
- B. Management and general
- C. Fundraising
- D. Allocated to A & B
- E. Allocated to A, B, C

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Net Asset Classifications

Net Asset Classification

Current GAAP

- Unrestricted
- Temporarily Restricted
- Permanently Restricted

New GAAP

- Without Donor Restrictions
- With Donor Restrictions

- ▶ **Net Assets without Donor Restrictions** – The component of net assets that is not subject to donor-imposed restrictions.
 - Management, the board or other governing body may not restrict funds
 - Includes board designated endowments

- ▶ **Net Assets with Donor Restrictions** – The component of net assets that is subject to donor-imposed restrictions.
 - “Donor” also refers to grantors or other contributors
 - Time restricted for future use
 - Endowment established by a donor
 - Purpose restrictions
 - Support for a particular activity
 - Acquisition of long lived assets

► Statement of Financial Position

- Two classifications representation the **minimum** required.
- Classifications are only required to be presented if applicable.
- Further disaggregation is permitted
- Must present a total for each of the two net asset classes
- Must present total net assets

► Statement of Activities

- Must present changes in net assets for each net asset class
- May present as one column or multiple columns
- Expenses will be shown as “without donor restrictions”
- Expiration of restrictions will continue to be shown as a release from restriction.

Net Asset Classification

	Current GAAP	Reclassifications	Revised GAAP
ASSETS			
Cash and cash equivalents	\$ 82,771	\$ -	\$ 82,771
Receivables	231,466	-	231,466
Prepaid expenses	8,739	-	8,739
Investments	59,419,060	-	59,419,060
TOTAL ASSETS	\$ 59,742,036	\$ -	\$ 59,742,036
LIABILITIES AND NET ASSETS			
Accounts payable and accrued expenses	\$ 173,611	\$ -	\$ 173,611
Deferred income	11,719	-	11,719
Total liabilities	185,330	-	185,330
NET ASSETS			
Unrestricted			
Designated	6,753,034	(6,753,034)	-
Undesignated	49,953,040	(49,953,040)	-
Temporarily restricted	1,741,064	(1,741,064)	-
Permanently restricted	1,109,568	(1,109,568)	-
Without donor restrictions	-	56,706,074	56,706,074
With donor restrictions	-	2,850,632	2,850,632
Total net assets	59,556,706	-	59,556,706
TOTAL LIABILITIES AND NET ASSETS	\$ 59,742,036	\$ -	\$ 59,742,036

Net Asset Classification

Net assets:

Without donor restrictions -

Undesignated	24,931
Operating reserve	25,000
Designated by the Board for capital projects	75,125
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	125,056

With donor restrictions -

Time restricted for future periods	2,783
Purpose restricted	11,066
Endowment fund	148,419
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	162,268
	<hr/>
Total net assets	287,324

Net Asset Classification



	<u>2017</u>	<u>2016</u>
Net assets:		
Net assets without donor restrictions	45,391,394	41,724,674
Net assets with donor restrictions		
Restricted by purpose or time	12,608,031	10,560,660
Restricted in perpetuity	36,450,653	35,381,690
	<u>49,058,684</u>	<u>45,942,350</u>
Total net assets	<u><u>94,450,078</u></u>	<u><u>87,667,024</u></u>

Net Asset Classification

	Without Donor Restriction	With Donor Restriction	Total
REVENUES			
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)	-
Total revenues	6,494,855	441,611	6,936,406
EXPENSES			
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
Total expenses	2,750,468	-	2,750,468
Change in net assets	3,744,387	441,611	4,185,938
NET ASSETS, beginning of year	52,961,687	2,409,081	55,370,768
NET ASSETS, end of year	\$ 56,706,074	\$ 2,850,692	\$ 59,556,706

Required Disclosures:

Net assets with donor restrictions:

- ▶ Composition of restrictions including, timing and nature of restriction, including how and when, if ever, the restriction expires
- ▶ Net assets released from restriction (purpose, time and appropriation of endowment amounts)
- ▶ Current option to release donor imposed restrictions over the useful life of a long lived asset has been eliminated

Net assets without donor restrictions:

- ▶ Amounts, purpose and type of board designations included in net assets without donor restrictions
- ▶ Actions by the Board that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period.

Question Time!

- Which of the following items should NOT be classified as Net Assets with Donor Restrictions?
 - A. Contribution to be used for a specific purpose
 - B. Endowment established by a governing body
 - C. Contribution of a long lived asset
 - D. Contribution to be used in the following fiscal year

Question Time!

- Which of the following items should NOT be classified as Net Assets with Donor Restrictions?
 - A. Contribution to be used for a specific purpose
 - **B. Endowment established by a governing body**
 - C. Contribution of a long lived asset
 - D. Contribution to be used in the following fiscal year



Other Changes

(investment earnings, cash flows & underwater endowments)

Other Changes

► Investment Earnings

- Investment expenses (external and direct internal) shall be **netted** against investment return and reported in the net asset category in which the **net investment return** is reported.
- This eliminates inconsistencies in reporting among not-for-profit entities.

► Statement of Cash Flows

- The net amount for operating cash flows using **either** the direct or indirect method of reporting is **still** required on the face of the Statement of Cash Flows.
- The presentation or disclosure of the indirect method **reconciliation**, if using the direct method, is **no longer** required.

Other Changes

OPERATING ACTIVITIES

Cash received from grantors	\$ 704,893
Cash payments to employees for services	<u>(256,619)</u>

Net cash provided by operating activities 15,903

CAPITAL AND RELATED FINANCING ACTIVITIES

Purchase of capital assets	(52,774)
Proceeds from sale of capital assets	<u>2,935</u>

Net cash used in capital
and related financing activities (49,839)

INVESTING ACTIVITIES

Interest received on investments	<u>761</u>
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Net cash provided by investing activities 761

Net change in cash and
and cash equivalents (33,175)

CASH AND CASH EQUIVALENTS, beginning of year 335,194

CASH AND CASH EQUIVALENTS, end of year \$ 302,019

Other Changes

Reconciliation of operating income to net cash provided by operating activities

Operating income	\$	445
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization		11,705
Changes in assets and liabilities		
Accounts receivable		2,595
Prepays and deposits		(200)
Accounts payable		(350)
Accrued salaries and wages		1,708
		<hr/>
Net cash provided by operating activities	\$	<u><u>15,903</u></u>

Other Changes

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$ 4,185,938
Adjustments to reconcile change in net assets to net cash used in operating activities	
Net unrealized and realized (gain) loss on investment securities	(4,737,944)
Change in operating assets and liabilities	
Accounts receivable	18,761
Prepaid expenses	(42)
Accounts payable and accrued expenses	<u>23,370</u>
Net cash used in operating activities	(509,917)

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of investments	(18,498,719)
Proceeds from sale or maturity of investments	<u>18,961,960</u>
Net cash provided by investing activities	<u>463,241</u>
Net change in cash and cash equivalents	(46,676)

CASH AND CASH EQUIVALENTS, beginning of year	<u>129,447</u>
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CASH AND CASH EQUIVALENTS, end of year	<u><u>\$ 82,771</u></u>
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Underwater Endowment Fund –

is a donor-restricted endowment fund for which the fair value of the fund at the reporting date has fallen below either the original gift amount or the amount required to be maintained by the donor or by law.

Other Changes

Underwater Endowment Funds – Financial Statements

Current GAAP: requires accumulated losses to be reflected as a **reduction of unrestricted net assets** and to present the endowment fund at the amount required to be maintained by the donor or by law.

New GAAP: requires the accumulated losses to be included **together** with the related fund in **net assets with donor restrictions**.

Underwater Endowment Funds – Disclosures

- The governing board's interpretation of the relevant state UPMIFA law as to its ability to spend from underwater endowment funds
- The entity's policy and any actions taken during the period concerning appropriation from underwater endowment funds.
- The fair value of the underwater endowment funds
- The original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions
- The amount of the deficiencies of the underwater endowment funds

Question Time!

Under new GAAP, the portion of endowment that is underwater should be included in which classification?

- A. Unrestricted
- B. Net assets with donor restrictions
- C. Net assets without donor restriction
- D. B or C

Question Time!

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- A. Unrestricted
- **B. Net assets with donor restrictions**
- C. Net assets without donor restriction
- D. B or C



Roadmap to Success

Roadmap to Success

Overall

- ▶ Start planning early
- ▶ Involve your auditors, audit/finance committees and board of directors in the planning process
- ▶ Gather information for new disclosures
- ▶ Review your endowments
- ▶ Review your policies on cost allocation and board-designated assets with your board of directors and audit committee

Classification of Net Assets

- ▶ Review your records to make sure funds are classified properly.
- ▶ Prepare a “draft” of your financial statements (including related net asset disclosures), to determine the level that is most appropriate to present your net assets on the face of the financial statements
- ▶ Review or set policies related to your board-designated net assets, as applicable.

Expenses

- ▶ Review formal and informal policies in place in regards to classification of expenses into functional and natural categories
- ▶ Review, revise or create written policies that notate allocation methodologies related to classification into functional expense categories
- ▶ Apply your allocation methodologies to the functional expense categories
- ▶ Prepare a “draft of your financial statements and disclosures related to allocation of expenses amongst programmatic and support categories, and disclosure of natural category. Evaluate the “end result”.

Liquidity & Availability of Resources

- ▶ Start calculating your available financial assets and your financial assets available within 1 year for comparative reporting and other items for liquidity disclosures.
- ▶ Set up a template for ease in making changes and updating from year to year.
- ▶ Prepare a “draft” of your financial statements, liquidity disclosures and availability of resources disclosures, including the quantitative and qualitative information
- ▶ Review this draft with senior management and your audit committee to ensure transparency in reporting.

Roadmap to Success

Investment Earnings

- ▶ Update accounting process (either in general ledger, grouping for financials statements or both) for investment earnings to display net investment return, rather than showing investment expenses separately from the gross investment earnings
- ▶ Ensure processes are in place to track direct investment expenses for the above

Cash Flow Statement

- ▶ Determine whether you are going to utilize the direct method or indirect method, based on the users of your financial statements

Roadmap to Success

Endowments

- ▶ Review all endowments to determine whether they are underwater at year-end
- ▶ Put process in place to track endowment funds, if not already in place
- ▶ Ensure underwater endowment amounts can be separated so the funds can be accounted for in net assets with donor restrictions rather than the underwater amounts being recorded in unrestricted funds upon implementation. Funds must be separated for the year of implementation and prior for retrospective application.
- ▶ Gather information related to the nature and amounts of restrictions and/or limitations related to the endowments that dictate how and when the net assets can be used.

Let's Take a Poll!

- ASU 2016-14 is...
 - A. Not as bad as I thought
 - B. Already giving me a headache
 - C. Ask me in a few months



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