

The webcast will start at 1 p.m. Eastern

Please note:

Handout – You can print or download the webcast handout at <http://capincrouse.com/asu-2016-14-webcast/>

CPE – CPE certificates will be emailed to you within the next few weeks. To receive CPE credit you must respond to the polling questions, which are not available on mobile devices. Therefore, in order to receive CPE credit you must log in via a computer.

Recording– A recording of today's webcast will be available at capincrouse.com. Click **Nonprofit Resources**, and then select **Webcast: Recorded** from the list on the right.



ASU 2016-14 Reporting Changes Are Finally Here:

What You Need to Do to Be Ready

Fran Brown, Partner
4.27.17





Financial Statements of Not-for-Profit Entities (ASU 2016–14)



Agenda

- Financial Statements of NFP Entities
- ASU 2016-14
 - Overview
 - Significant Changes
 - Dates
- Example

Financial Statements of Not-for-Profit Entities

Key Objectives

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
 - Financial performance
 - Cash flows
 - Liquidity
- Better enable NFPs to “tell their financial story”

Phase I Aim: Final ASU by mid-2016, effective for calendar year 2018 (fiscal year 2018-19)	Phase II
Net Asset Classes: <ul style="list-style-type: none"> • Classification scheme • Disclosure of board designated net assets • Underwater endowments • Expirations of capital restrictions 	Operating Measures – all other elements of the proposal, including: <ul style="list-style-type: none"> • Whether to require intermediate measure(s) • Whether and how to define such measure(s), and what items should or should not be included in the measure(s) • Alternative disaggregation approaches suggested by stakeholders
Expenses/Investment Return: <ul style="list-style-type: none"> • Expenses by nature; analysis of expenses by function and nature • Netting of investment expenses against investment return • Disclosure of netted investment expenses • Enhanced disclosures about cost allocations 	
Operating Measures: <ul style="list-style-type: none"> • Modest improvements to disclosures for those that use an operating measure, especially about board appropriations, designations, and similar transfers 	
Liquidity/Availability: <ul style="list-style-type: none"> • Quantitative disclosures about availability • Qualitative disclosures about liquidity • Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet) 	
Statement of Cash Flows: <ul style="list-style-type: none"> • Methods of presenting operating cash flows (direct/indirect) 	
	Statement of Cash Flows: <ul style="list-style-type: none"> • Realignment of certain items

Key Phase I Changes (Amendments to Current GAAP)

- Allowing free choice between direct method and indirect method in presenting operating cash flows
- Improving presentation and disclosures for net asset classes
- Enhancing information about the liquidity and availability of financial resources
- Providing better information about expenses and expense allocation
- Improving reporting of investment return

Cash Flow Statement

- Allow free choice between the **Direct Method** and the **Indirect Method** in presenting operating cash flows
 - Indirect reconciliation no longer required for Direct Method

Net Assets

Current
GAAP

Unrestricted

Temp.
Restricted

Perm.
Restricted

Revised
GAAP

Without Donor
Restrictions*

With Donor Restrictions*

+

Disclosures

Amount, purpose,
and type of board
designations**

Nature and amount
of donor restrictions

* NFPs may choose to disaggregate further

** New disclosure requirement

“Underwater” Endowments

Revised net asset classification

- To be reflected in net assets with donor restrictions rather than in net assets without donor restrictions

Enhanced disclosures

- In addition to aggregate amounts by which funds are underwater (current GAAP), also disclose aggregate of original gift amounts (or level required by donor or law) for such funds, fair value, and any governing board policy, or actions taken, concerning appropriation from such funds

Expiration of Capital Restrictions

- Gifts of cash restricted for acquisition or construction of PP&E
 - In absence of explicit donor restrictions, NFPs would be required to use the **placed-in-service** approach (*no more implied time restrictions*)
 - Healthcare NFPs are already required to do so

Liquidity and Availability of Resources

NFPs required to provide:

- **Qualitative** information on how an NFP manages its liquid available resources and its liquidity risk (in the notes)
- **Quantitative** information that communicates the availability of an NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)

Quantitative Disclosure for Financial Assets Availability Example

Financial assets, at year-end*	\$234,410
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions**	(144,500)
Investments held in annuity trust	(4,500)
Amounts held by bond trustees	(30,200)
Board designations:	
Quasi-endowment fund, primarily for long-term investing**	(36,600)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	\$5,370

*Total assets, less nonfinancial assets (e.g., PP&E, inventory, prepaids)

**Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions

Expense Reporting

- Report expenses, either on the face of financial statements or in the notes, by:
 - Function*
 - Natural classification
 - Analysis (disaggregate function by nature)**

* **Currently required in GAAP**

** **Choice of location; Board may explore segment reporting instead for HC in Phase 2**

Expense Reporting (cont'd.)

- NFPs required to provide qualitative disclosures about methods used to allocate costs among program and support functions
- ASU also provides enhanced guidance on allocations from M&G expenses
 - Key concept: **direct conduct** or **direct supervision**

Reporting of Investment Return

How to present?

- **Net presentation** of investment expenses against investment return on the face of the statement of activities
 - Netting limited to external and **direct** internal expenses
 - May report net return in **multiple**, appropriately labeled lines (e.g., from different portfolios, in different net asset classes, or in operating versus nonoperating)

What to disclose?

- Disclosure of investment expenses **no longer required**
 - If reported, carefully label and don't include in expense analysis
- No longer require disclosure of investment return **components**

Operating Measure: Improved Disclosures

- Reinforcing current GAAP requirement about transparency of components of any operating measures presented:
 - *NFPs utilizing an operating measure that reflects governing board designations, appropriations, and similar actions (internal transfers) must report these types of internal transfers appropriately disaggregated and described by type (either on the face of the statement of activities or in the notes)*

Effective Date, Early Adoption, and Transition

- **Effective Date:** For fiscal years beginning after 12/15/2017 (CY 2018, FY 2018-19)
 - Interim financials the following year
- **Early Adoption:** Permitted, but must apply the regular transition provisions
- **Transition:**
 - For year of adoption: apply all provisions
 - For comparative years presented: apply all provisions, except can choose not to present:
 - 1) Analysis of expenses by nature and function,* and/or
 - 2) Disclosures around liquidity and availability of resources

**unless already required to do so under current GAAP*

Important Notes

- NFPs are already permitted to incorporate many of the changes in the ASU
- The only changes that cannot be done without formally adopting the ASU are:
 1. Presenting one class of restricted net assets (consolidating temporarily and permanently restricted)
 2. Underwater endowment accounting
 3. Eliminated disclosures of investment return components and netted expenses
 4. Eliminated requirement to provide indirect reconciliation if using direct method for operating cash flows

One Statement Approach Statement of Activities

	Without Donor Restrictions	With Donor Restrictions	Total
OPERATING ACTIVITIES			
Revenue and support:			
Fees for services	\$ 495		\$ 495
Bequests	600		600
Other contributions	425	1,500	1,925
Restricted support released	1,375	(1,375)	
Revenue and support	2,895	125	3,020
Expenses:			
Expenses	1,950	-	1,950
Revenues and support in excess of expenses before transfers	945	125	1,070
Transfers			
Transfers to operating activities	150	a	150
Transfers from operating activities	(500)	b	(500)
Revenues and support in excess of expenses after transfers	\$ 595	\$ 125	\$ 720
NONOPERATING ACTIVITIES			
Interest expense	(75)		(75)
Investment return, net	170	445	615
Transfers			
Transfers to operating activities	(150)	a	(150)
Transfers from operating activities	500	b	500
	350		350
Total change in net assets	1,040	570	1,610
Net assets at the beginning of the period	1,500	2,100	3,600
Net assets at the end of the period	\$ 2,540	\$ 2,670	\$ 5,210

■ Operating ■ Nonoperating w/o donor restrictions ■ With donor restrictions

Two Statement Approach Statement of Operations

OPERATING ACTIVITIES

Revenue and Support:

Fees for services
Bequests
Other contributions
Restricted support released

Revenue and support

Expenses:

Expenses

Revenues and support in excess of expenses before transfers

Transfers

Transfers to operating activities
Transfers from operating activities

Revenues and support in excess of expenses after transfers

\$	495	
	600	
	425	
	1,375	
	<u>2,895</u>	
	1,950	
	945	
	150	a
	(500)	b
	<u>(350)</u>	
\$	<u>595</u>	c

*No longer a requirement to report operating measure on same page as change in net assets without donor restrictions

Two Statement Approach (continued) Statement of Changes in Net Assets

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues and support in excess of expenses after transfers	\$ 595 c	\$	\$ 595
NONOPERATING ACTIVITIES			
Contributions		1,500	1,500
Restricted support released		(1,375)	(1,375)
Interest expense	(75)		(75)
Investment return, net	170	445	615
Transfers			
Transfers to operating activities	(150) a		(150)
Transfers from operating activities	500 b		500
	<u>350</u>		<u>350</u>
Changes in Net Assets	1,040	570	1,610
Net assets at the beginning of the period	<u>1,500</u>	<u>2,100</u>	<u>3,600</u>
Net assets at the end of the period	<u>\$ 2,540</u>	<u>\$ 2,670</u>	<u>\$ 5,210</u>

■ Operating ■ Nonoperating w/o donor restrictions ■ With donor restrictions

Selected Implementation Issues ASU 2016-14

- Financial Statement Format – Decisions
- Expense Analysis by Natural and Functional
- Cost Methodology Issues
- Disclosure of Board Designations
- Disclosure of Liquidity and Financial Assets Available
- Cash Flow Statement – Optional Direct Method

Opportunity to Improve Statement Format

- Perfectly happy with your statement of act. format?
 - Board may have finally figured out how to read your existing format
 - Maybe you don't want your board to know there are reporting alternatives
 - Then take the minimalist approach – that's okay
- ASU 2016-14 gives you an excuse to make improvements
- Researching the options

Format Changes

- Statement of Activities
 - Moved from a columnar to pancake format
 - Seriously considered SOA format used by U of Chicago and Stanford
 - Selected 958-205-56-15 Format C – very similar to University of Notre Dame
 - Expenses on face by natural classification rather than functional
- Cash Flow Statement
 - Chose Direct Method since it would correlate to SOA

Correlating: Stmt of Activities to Cash Flow Stmt

Statement of Activities – line items	Net Cash from Operating Activities
Tuition and fees	Cash received from tuition and fees
Contributions	Cash received from donors
	Cash from contribution receivables
Auxiliary enterprises	Cash received fr auxiliary enterprises
Investment return, net	Interest and dividends received*
Educational activities and other income	Miscellaneous receipts
Salaries and wages	Cash paid to employees
Employee benefits & Pension-related changes other than Net Periodic costs	Cash paid for benefits
Services, supplies, and other & Occupancy, utilities, and maintenance	Cash paid to suppliers and vendors
Interest	Interest paid
Grants to others	Grants paid
Depreciation and amortization	n/a

	June 30, 2016
Changes in net assets without donor restrictions:	
Operating Revenues and Other Additions:	
Tuition and fees, net of scholarship allowances of \$3,3273,496	\$ 15,008,697
Contributions	14,945,333
Investment return, net appropriated for operations	784,601
Educational activities and other income	948,639
Auxiliary enterprises	3,171,122
Total operating revenues	<u>34,858,392</u>
Net assets released from restrictions:	
Satisfaction of program restrictions	3,249,817
Appropriation from donor endowment and subsequent of any related donor restrictions	1,882,148
Total net assets released from restrictions	<u>5,131,965</u>
Total Operating Revenues and Other Additions	<u>39,990,357</u>
Operating Expenses	
Salaries and wages	16,603,156
Employee benefits	6,872,309
Services, supplies, and other	6,096,200
Occupancy, utilities, and maintenance	2,987,822
Grants to others	2,696,719
Depreciation and amortization	2,572,531
Interest	689,145
Total Operating Expenses	<u>38,517,882</u>
Change in Net Assets from Operations	<u>1,472,475</u>
Non-Operating Changes in Net Assets Without Donor Restrictions	
Pension related changes other than net periodic pension cost	(3,560,167)
Investment return, net	(40,738)
Change in value of split-interest agreements	(359,756)
Net assets released from restrictions due to acquisition of long-lived assets	12,234,065
Change in Net Assets from Nonoperating Activities	<u>8,273,404</u>
Change in Net Assets Without Donor Restrictions	<u>\$ 9,745,879</u>

Changes in net assets without donor restrictions:	
Operating revenues and other additions	\$ 39,990,357
Operating expenses	<u>(38,517,882)</u>
Change in Net Assets from Operations	1,472,475
Change in Net Assets from Nonoperating Activities	<u>8,273,404</u>
Change in net assets without donor restrictions	<u>9,745,879</u>
Changes in net assets with donor restrictions:	
Contributions	6,614,538
Investment return, net	(4,596)
Net assets released for restrictions	
Release of appropriated endowment amounts	(1,882,148)
Release of restrictions related to long-lived assets placed into service	(12,234,065)
Release of other restrictions	(3,249,817)
Change in value of split-interest agreements	132,739
Other changes	10,002
Changes in net assets with donor restrictions:	<u>(10,613,347)</u>
Changes in net assets	(867,468)
Net Assets at Beginning of Year	88,534,492
Net Assets at End of Year	<u>\$ 87,667,024</u>

Refer to 958-205-55-15 Format C

Expense by Natural and Functional

- Reporting by natural class was new
- How many categories? Easy to roll up on system?
 1. Salaries and wages
 2. Employee benefits
 3. Services, supplies, and other ?????
 4. Occupancy, utilities, and maintenance ?????
 5. Grants to others
 6. Depreciation and amortization
 7. Interest
- Research – ASU examples, other universities

Expense By Both their Nature and their Function

	Program Activities			Supporting Activities			Total Expense 2016
	Academic and Student		Auxiliaries	Facilities			
	Programs	Public Service		Administrative Support	operation & maintenance	Fundraising	
Salaries and wages	\$ 10,026,575	\$ 251,127	\$ 627,796	\$ 3,506,843	\$ 884,896	\$ 1,305,958	\$ 16,603,194
Employee benefits	3,590,259	65,647	268,684	2,288,274	493,262	116,938	6,823,064
Services, supplies, and other	2,667,856	217,448	602,060	1,193,442	298,397	1,168,202	6,147,405
Occupancy, utilities, and maintenance	83,221	1,339	499,092	94,233	2,303,240	6,697	2,987,823
Grants to others	285,658	2,409,061	-	-	-	-	2,694,719
Depreciation and amortization	808,039	26,947	1,394,612	284,313	49,833	8,788	2,572,532
Interest	-	-	689,145	-	-	-	689,145
	17,461,608	2,971,569	4,081,389	7,367,106	4,029,628	2,606,582	38,517,882
Facilities operation and maintenance	1,859,326	76,466	897,467	1,022,227	(4,029,628)	174,142	-
Total operating expense in FY 16	\$ 19,320,935	\$ 3,048,035	\$ 4,978,856	\$ 8,389,333	\$ -	\$ 2,780,724	\$ 38,517,882

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Seminary. These expenses include depreciation and amortization, interest, the president's office, communications, media production, information technology, and facilities operations and maintenance. Depreciation is allocated base on square footage and interest is allocated based on usage of space. Costs of other categories were allocated on estimates of time and effort.

For example: 958-205-55-21 Note F (Page 66 of ASU) or Dartmouth

Cost Methodology Issues

Allocation	Current Cost Allocation Method	Revised Allocation Method
Facilities O&M	Sq. Footage basis	Service & effort estimate
Depreciation & amortization	Sq. Footage basis	No change
Interest	Usage of Space	No change
IT-related costs (allocation now required)	Did not allocate	Service & effort estimate (easier than thought)

Disclosure on Board Designations of Net Assets Without Donor Restrictions

- Net assets earmarked for:
 - Future programs
 - Investment
 - Contingencies
 - Purchases of construction of fixed assets
 - Or other assets
- Since the examples include the “entire universe” of possible buckets, the application rests on the meaning of “earmarked”

Disclosure on Board Designations of Net Assets Without Donor Restrictions

- Management policy to invest gifts for CGAs, donor advised funds, quasi-endowments
- Identify amounts that were specifically set aside:
 - as a contingency,
 - for maintenance and renovations,
 - for a specific future program (something with formal approval by management)
- Primary characteristic of Undesignated amounts is their final use is not yet determined (Not-Yet-Determined Test)

Example

Board Designations Net Assets Without Restrictions

The Seminary's governing board through specific action or through management policy has created self-imposed limits on net assets without donor restrictions. The board has earmarked \$16,524,722 for the following purposes as of June 30, 2016.

	<u>June-30-2016</u>
For Investment:	
Donor advised funds	\$ 14,182,372
Board designated-endowment	604,086
Annuity reserves	537,227
Maintenance and renovation projects	474,289
Reserves for contingency and other	726,748
	<u>\$ 16,524,722</u>

Disclosures on Liquidity and Availability

Qualitative – example

- The following table reflects the Seminary's financial assets as of June 30, 2016, reduced by amounts not available for general use within one year, either because of donor-imposed restrictions, illiquid or not convertible to cash within one year, or because the governing board or management policy has set aside the funds for a specific use. Amounts not available include amounts set aside for investing of annuity funds, donor advised funds, quasi-endowments, and for trusts.
- As of June 30, 2016, the Seminary has cash and cash equivalents on hand to cover 72 days of operating expenses. The Seminary has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. The Seminary also has an unsecured \$5,000,000 line of credit, which it could draw upon in the event of an anticipated liquidity need. No funds were borrowed under this agreement during the fiscal year ended June 30, 2016.

Disclosures on Liquidity and Availability

Quantitative – example

Financial Assets, at year-end	\$ 98,552,576
Less those unavailable for general expenditure within one year, due to:	
Contractual or Donor-imposed restrictions:	
Contractual or restricted by donor with time or purpose restrictions	10,781,947
Investments not convertible to cash within next 12 months	2,954,525
Subject to appropriation and satisfaction of donor restrictions	36,449,919
Investments held in trusts	18,618,431
Board designated financial assets without donor restriction:	
For investment	16,434,088
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 13,313,666</u>

Disclosures on Liquidity and Availability

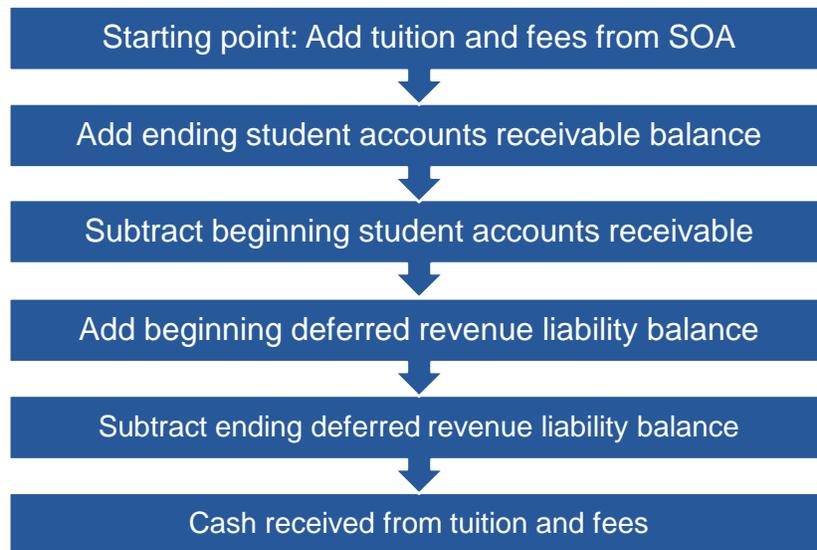
Examples of limitations that may make financial assets unavailable		
Its nature	Financial assets not convertible to cash within next 12 months	Contribution receivables due > 1 year
		Accounts/Notes receivable due > 1 year
		Illiquid investments not redeemable within 1 year
External limits of donors, 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
	Contracts or legal restrictions	Trusts and life income funds
		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
	Intended for future years	Donor advised funds
		Designated to future construction or deferred maintenance expected beyond 1 year (or all assets intended for long-lived assets???)

Cash Flow Method – How Hard is Direct Method?

- Use the indirect approach to construct direct method
- Assign SOA line items to likely cash flow statement (CFS) line item categories
 - Chart of Account and system limitations
- Analyze changes in Balance Sheet Accounts to determine Adjustments
 - Compare beginning balance to ending balance
 - Identify which SOA category it would affect

Operating Section	Amounts from SOA – recast to CFS	Adj for analysis of bal sheet accts	Cash Flow Statement
Cash received from tuition and fees	\$15,008,697	\$316,111	\$15,324,808
Cash received from donors	21,559,871	(6,587,990)	14,971,881
Cash collected from contributions receivable	-	2,162,147	2,162,147
Cash received from auxiliary enterprises	3,171,122	(14,014)	3,157,108
Interest and dividends received	-	1,071,499	1,071,499
Investment return, net	739,267	(739,267)	-
Miscellaneous receipts	958,641	(400)	958,241
Change in value of split-interest agreements	(227,017)	227,017	-
Cash paid to employees	(16,603,156)	(25,628)	(16,628,784)
Cash paid for benefits	(10,432,476)	3,823,995	(6,608,481)
Cash paid to suppliers and vendors	(9,084,022)	(888,246)	(9,972,268)
Interest paid	(689,145)	(1,680)	(690,825)
Grants paid	(2,696,719)	-	(2,696,719)
Depreciation and amortization	(2,572,531)	2,572,531	-
Net Cash Provided by Operating Activities	\$(867,468)	\$1,916,076	\$1,048,608

The “Indirect Approach” to Direct Method



Analysis of Balance Sheet Accounts

Identify changes that correlate to Categories on Cash Flow Statement

Accounts & Note Receivable, net	Prior Year \$784,423	Current Year \$610,024	Difference \$174,399	
Cash received from tuition and fees	\$ 470,568	446,211	24,357	A 1
Cash received from auxiliary enterprises	27,389	53,185	(25,796)	A 2
Miscellaneous receipts	2,912	1,320	1,592	A 4
Interest and dividends received	-	4,250	(4,250)	A 5
Cash paid for benefits	140,208	-	140,208	A 6
Cash paid to suppliers and vendors	34,299	27,999	6,300	
Proceeds from note receivable collection	109,047	77,059	31,988	A 8
	\$ 784,423	610,024	174,399	

Analysis of Balance Sheet Accounts, continued

Identify changes that correlate to categories on Cash Flow Statement

Contributions receivable, net	Prior Year \$5,315,773	Current Year \$3,646,381	Difference \$1,669,394	
Cash received from donors (pledge additions)	Refer to Contribution Receivable Audit Roll Forward		(546,173)	A 9
Cash collected from contribution receivables			\$2,162,147	A 10
Cash paid to suppliers & vendors (happens to be group where bad debt expense recorded)			53,418	A 11
			\$1,669,394	

Complete analysis of remaining Balance Sheet Account Group

Operating Activities – Direct Method

	2016
Cash Flows from operating activities	
Cash received from tuition and fees	\$ 15,324,808
Cash received from donors	14,971,881
Cash collected from contributions receivable	2,162,147
Cash received from auxiliary enterprises	3,157,108
Interest and dividends received	1,071,499
Investment return, net	0
Miscellaneous receipts	958,241
Change in value of split-interest agreements	0
Cash paid to employees	(16,628,784)
Cash paid for benefits	(6,608,481)
Cash paid to suppliers and vendors	(9,972,268)
Interest paid	(690,825)
Grants paid	(2,696,719)
Depreciation and amortization	0
Net Cash Provided by Operating Activities	1,048,608

Final Words

Implementing the ASU can take longer than you think

- Start working on Expense Analysis by natural and function and work through the format issues sooner rather than later
- Assess your cost allocation methods – contact IT now if you currently don't allocate
- Attempt to construct the Board Designation before doing the Liquidity & Availability disclosures

Beginning sooner rather than later will make final implementation so much easier.

Staying Current

- Sign up for electronic Action Alert
- FASB on Twitter
- www.fasb.org
 - Recently issued ASUs
 - Project pages on FASB website
 - Project summaries
 - FASB in Focus executive summaries
 - Podcasts/webcasts

Acknowledgements

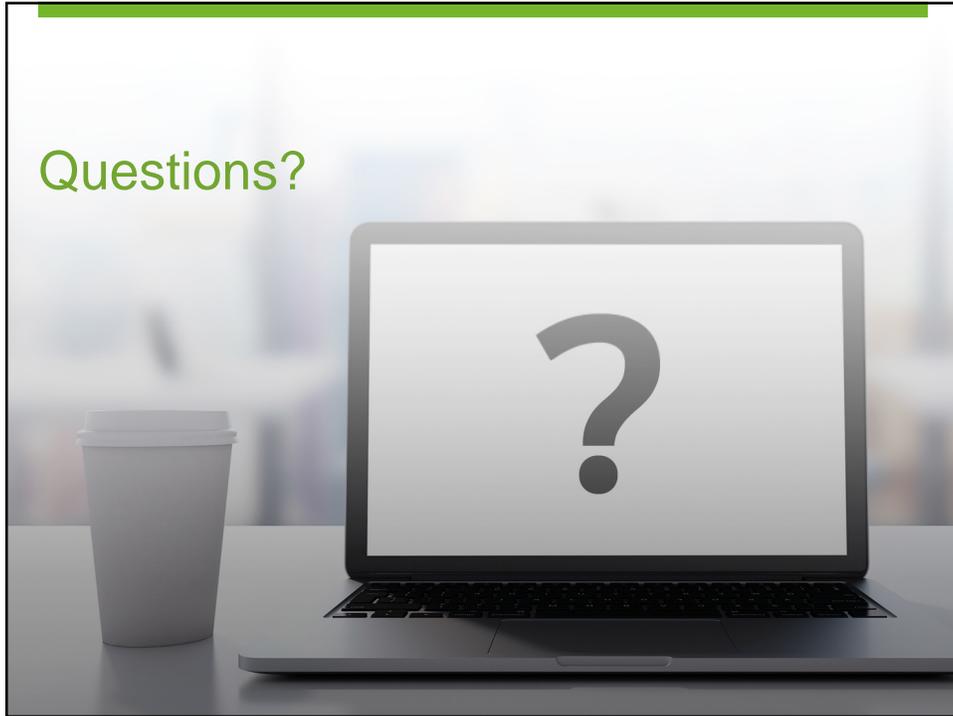
Dale Larson, VP for Business and Finance

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Questions?



Thank you.

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