New Accounting Rules: What you need to Know

Learn more about ASU 2016-14 and ASU 2018-08

Presenters

Carole McNees

Partner

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As part of the professional standards leadership team, I provide guidance and oversight to our assurance practice across the firm and am heavily involved in developing the firm's audit strategy of the future. I was previously the industry technical leader for the real estate and construction industry group — and I continue to support the accounting and assurance technical needs for clients and staff in that industry, as well as the energy sector.

With more than 20 years of experience, I'm skilled at developing solutions to technical assurance issues through collaboration with individual engagement teams and clients, always striving for the best outcome for our clients. I'm known for resolving challenges while working within the framework of the applicable professional standards to maintain the high level of quality demanded from the accounting profession.

I've presented at a number of industry association events, primarily to talk about significant upcoming accounting changes. I've also presented at a national affordable housing conference on reporting and audit strategy topics. I'm a member of the AICPA and the MICPA. I received my B.B.A. in accounting from Western Michigan University.

I'm on the board of directors for LIFT Foundation, a nonprofit organization that provides affordable housing in my community.

Presenters

Toni Diprizio, CPA

Partner

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I specialize in the not-for-profit industry in Chicago and advise clients and their boards on upcoming accounting standards, board governance, industry trends, and best practices. I have expertise in audits, single audits, grant-specific audits, employee benefit plan audits, and agreed-upon procedures engagements. It's my passion serving a range of clients in the not-for-profit industry including arts and cultural institutions, trade and professional associations, social service organizations, private foundations, and private and independent schools.

Even with more than 20 years in public accounting, there's always something new to discover. I love learning about my client's organizations, their missions, and how they deliver value to the populations they serve. It's very satisfying to provide ideas that can improve their overall operations, thereby allowing them to focus their efforts on mission-related activities.

One of my goals with clients is to make sure they're never surprised — in a bad way. Our team works to address potential issues and find effective resolutions. Of course, even with proactive planning, things don't always go smoothly. Flexibility is the key to handling the unexpected. I'm proud of how our teams collaborate and prioritize client's needs to ensure that unanticipated challenges are effectively resolved and all deadlines can be met.

I belong to the AICPA, the Illinois CPA Society, and the American Society of Association Executives (ASAE). I've been involved with the Emerald City Theatre Company in various roles for more than 10 years. I hold a B.S. in accounting from the University of Illinois at Chicago.

TD1

Overview of today's discussion

- ASU 2016-14 Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities:
  - Scope and Effective Date
  - Changes to Net Assets
  - Liquidity and Availability
  - Expense Classification
  - Other Changes
- ASU 2018-08 Not-for-Profit Entities (Topic 958) Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made:
  - Scope and Effective Date
  - Exchange vs. Contribution
  - Conditional vs. Unconditional
  - Disclosures

Slide 4

TD1 Determine what section we want to lead with and condense the overview - need to add single audit and REAC updates
Toni Diprizio, 11/19/2018

Presentation of Financial Statements of NFP Entities

ASU 2016-14

Scope and Effective Date

Who?

NFP entities who follow FASB NFP rules such as:

- Charities
- Foundations
- Private colleges/universities
- Nongovernment healthcare providers
- Cultural institutions
- Religious organizations
- Trade associations
- HUD projects

Why?

Goals of the new standards:

- Provides better information to donors, creditors, and other users of the financial statements
- Clarifies and simplifies net asset classifications
- Provides more uniformity in presenting expenditures
- Enhances the presentation of the statement of cash flows

When?

Effective for years beginning after December 15, 2017 (effectively years ended December 31, 2018 and beyond)

- Early implementation permitted
- Must be applied on a retrospective basis, however, NFPs can elect not to provide certain comparative disclosures in the year of adoption only
  - Analysis of expenses by both natural and functional classification
  - Disclosures about liquidity and available resources
- In initial year of applications, NFPs required to disclose nature of any reclassifications or restatements resulting from the adoption and their effect, if any, on change in net asset classes for each year/period presented

Changes to Net Assets

Changes to Net Assets Classification

Current GAAP	Unrestricted	Temp. Restricted	Perm Restricted
ASU 2016-14	Without Donor Restrictions	With Donor Restrictions	
+			
Disclosures	Amount and purpose of board designations	Nature and amount of donor restrictions	

New Statement of Financial Position – Unclassified (in order of liquidity)

Not-for-Profit Entity A
Statements of Financial Position
June 30, 20X1 and 20X0
(in thousands)

	20X1	20X0
Assets:		
Cash and cash equivalents	$4,575	$4,960
Accounts and interest receivable	2,130	1,670
Inventories and prepaid expenses	610	1,000
Contributions receivable	3,025	2,700
Short-term investments	1,400	1,000
Assets restricted to investment in land, buildings, and equipment	5,210	4,560
Land, buildings, and equipment	61,700	63,590
Long-term investments	218,070	203,500
Total assets	$296,720	$282,980
Liabilities and net assets:		
Accounts payable	$ 2,570	$ 1,050
Refundable advance		650
Grants payable	875	1,300
Notes payable		1,140
Annuity trust obligations	1,685	1,700
Long-term debt	5,500	6,500
Total liabilities	10,630	12,340
Net assets:		
Without donor restrictions (Note DD)	92,600	84,570
With donor restrictions (Note B)	193,490	186,070
Total net assets	286,090	270,640
Total liabilities and net assets	$296,720	$282,980

New Statement of Financial Position - Classified

Assets:		
Current assets		
	Cash and cash equivalents	$ 4,575
	Contribution receivables	1,825
Noncurrent assets		
	Contribution receivables	1,200
	Long-term investments	10,000
Total assets		$ 17,600
Liabilities and net assets:		
Current liabilities:		
	Accounts payable	$ 2,570
	Grants payable	550
Noncurrent liabilities:		
	Notes payable	5,500
Net assets:		
	Without donor restrictions	1,275
	With donor restrictions	7,705
Total liabilities and net assets		$ 17,600

New Statement of Activities – Format A

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

Changes in net assets without donor restrictions:	
Revenues and gains:	
Contributions	$ 8,640
Fees	5,200
Investment return, net	6,650
Gain on sale of equipment	200
Other	150
Total revenues and gains without donor restrictions	20,840
Net assets released from restrictions (Note D):	
Satisfaction of program restrictions	8,990
Satisfaction of equipment acquisition restrictions	1,500
Expiration of time restrictions	1,250
Appropriation from donor endowment and subsequent satisfaction of any related donor restrictions	7,500
Total net assets released from restrictions	19,240
Total revenues, gains, and other support without donor restrictions	40,080
Expenses and losses:	
Salaries and benefits	15,115
Changes in net assets with donor restrictions:	
Contributions	8,390
Investment return, net	18,300
Actuarial loss on annuity trust obligations	(30)
Net assets released from restrictions (Note D)	(19,240)
Increase in net assets with donor restrictions	7,420
Increase in total net assets	15,450
Net assets at beginning of year	270,640
Net assets at end of year	$ 286,090

TD3

New Statement of Activities – Format B

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues, gains, and other support:			
Contributions	$ 8,640	$ 8,390	$ 17,030
Fees	5,200		5,200
Investment return, net	6,650	18,300	24,950
Gain on sale of equipment	200		200
Other	150		150
Net assets released from restrictions (Note D):			
Satisfaction of program restrictions	8,990	(8,990)	
Satisfaction of equipment acquisition restrictions	1,500	(1,500)	

Slide 15

TD3 We don't really have a HUD specific example but I think we can describe the lines that would change on balance sheet and statement of activities

Toni Diprizio, 11/19/2018

Net asset disclosures in the footnotes

Must disclose the nature and amount of the different types of donor-imposed restrictions, such as those:

- Assets donated with restrictions that they be used for a specified purpose, be preserved, and not be sold;
- Assets donated with stipulations they be invested to provide a permanent source of income;
- Restricted for support of particular operating activities;
- Restricted for investment for a specified time;
- Restricted for use in a future period;
- Restricted for the acquisition of long-lived assets.

Net asset disclosures in the footnotes

Must disclose information about self-imposed limits, such as board designations.

NFP A's governing board has designated, from net assets without donor restriction of $100,000, net assets for the following purposes as of June 30, 20X1:

Quasi-endowment	$100,000
Liquidity reserve	500,000
Total	$600,000

Net asset disclosures in the footnotes

Useful, but not required (releases 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.

Purpose restrictions accomplished:	
Program A expenses	$XX
Program B expenses	XX
Time restrictions expired:	
Passage of specific time	XX
Death of annuity beneficiary	XX
Release of appropriated endowment amounts without purpose restrictions	XX
Release of appropriated endowment amounts with purpose restrictions	XX
Total restrictions released	**$XX**

Underwater endowment funds

Reflected in net assets with donor restrictions

Additional required disclosures:

- NFP's policies and actions taken during that period concerning appropriation from underwater endowment funds
- Aggregate fair value of such funds
- Aggregate of the original gift amounts (or level required by donor or law) to be maintained
- The aggregate amount by which funds are underwater (deficiencies), which are to be classified as part of net assets with donor restrictions (d = b – c)

Endowment footnote

- Old

200Y
Endowment Net Asset Composition by Type of Fund
as of June 30, 200Y

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (200) [11]	$ 39,589	$ 97,959	$ 137,348
Board-designated endowment funds	7,084	-	-	7,084
Total funds	$ 6,884	$ 39,589	$ 97,959	$ 144,432

- NEW

200Y
Endowment Net Asset Composition by Type of Fund as of June 30, 200Y

	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	$ 7,084	$ -	$ 7,084
Donor-restricted endowment funds:			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	97,759	97,759
Accumulated investment gains	-	35,201	35,201
Term endowment	-	4,388	4,388
Total funds	$ 7,084	$ 137,348	$ 144,432

Changes to Net Assets - REAC

Balance Sheet:

Account Number	Old Account Name	New Account Name
3131	Unrestricted Net Assets	Net Assets Without Donor Restrictions
3132	Temporarily Restricted Net Assets	REMOVE THIS ACCOUNT
3133	Permanently Restricted Net Assets	Net Assets With Donor Restrictions
3130	Total Net Assets	No change

Statement of Activities:

Account Number	Old Account Name	New Account Name
3247	NEW ACCOUNT	Change in Net Assets Without Donor Restrictions
3249	NEW ACCOUNT	Change in Net Assets With Donor Restrictions
3250	Change in Total Net Assets from Operations	N/A

Changes to Net Assets - REAC

Statement of Changes in Net Assets (if applicable):

Account Number	Old Account Name	New Account Name
S1100-060	Previous Year Unrestricted Net Assets	Previous Year Net Assets Without Donor Restrictions
3247	Change in Unrestricted Net Assets from Operations	Change in Net Assets Without Donor Restrictions
S1100-065	Other Changes in Unrestricted Net Assets	Other Changes in Net Assets Without Donor Restrictions
3131	Unrestricted Net Assets	Net Assets Without Donor Restrictions
S1100-070	Previous Year Temporarily Restricted Net Assets	REMOVE THIS ACCOUNT
3248	Change in Temporarily Restricted Net Assets from Operations	REMOVE THIS ACCOUNT
S1100-075	Other Changes in Temporarily Restricted Net Assets	REMOVE THIS ACCOUNT
3132	Temporarily Restricted Net Assets	REMOVE THIS ACCOUNT
S1100-080	Previous Year Permanently Restricted Net Assets	Previous Year Net Assets With Donor Restrictions
3249	Change in Permanently Restricted Net Assets from Operations	Change in Net Assets With Donor Restrictions
S1100-085	Other Changes in Permanently Restricted Net Assets	Other Changes in Net Assets With Donor Restrictions
3133	Permanently Restricted Net Assets	Net Assets With Donor Restrictions

Liquidity and Availability

Increased Note Disclosures surrounding Liquidity and Availability

Liquidity – Relates to the type of asset the Organization has and the maturity of that asset.

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

Quantitative and Qualitative disclosures in the Notes

Increased Disclosures surrounding Liquidity and Availability

- Quantitative information about the availability of financial assets at balance sheet date to meet cash needs for general expenditures within one year of balance sheet date
- **Examples include disclosing:**
  - Total amount of financial assets
  - Amounts that are not available to meet cash needs within the time horizon because of (1) external limits and (2) internal actions of a governing board
  - Total amount of financial liabilities that are due within that time horizon
- **Can be accomplished through either:**
  - Classified balance sheet
  - Segregation and disclosure of assets whose use is limited
  - Additional disclosures in the footnotes

Increased Disclosures surrounding Liquidity and Availability

- **Qualitative** information about how the entity manages its liquid resources available to meet cash needs for general expenditures within one year of balance sheet date

- Examples of relevant qualitative information
  - Minimum cash balance goals
  - Use of a line of credit
  - Policy for managing excess cash

Increased Disclosures surrounding Liquidity and Availability

Example A – Liquidity/Availability note (paragraph format)

Quantitative

NFP A has $395,000 of financial assets available within 1 year of the balance sheet date to meet cash needs for general expenditure 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 implied time restrictions but are expected to be collected within one year.

Qualitative

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. NFP A has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, NFP A invests cash in excess of daily requirements in various short-term investments, including certificate of deposits and short-term treasury instruments. As more fully described in Note XX, 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.

Increased Disclosures surrounding Liquidity & Availability

Example B – Liquidity/availability note (table + paragraph format)

Quantitative

NFP A's financial assets available within one year of the balance sheet date for general expenditure 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	10,804
Total financial assets	$20,734

Increased Disclosures surrounding Liquidity & Availability

Example B – Liquidity/Availability note (table + paragraph format) (Continued)

Qualitative

NFP A's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. As described in Note Y, 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.

As part of NFP A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, NFP A 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 process, amounts from its quasi-endowment could be made available if necessary. However, both the quasi-endowment and donor-restricted endowments contain investments with lock-up provisions that would reduce the total investments that could be made available (see Note X for disclosures about investments).

Increased Disclosures surrounding Liquidity & Availability

Example C – Liquidity/availability note (table + paragraph format)

Qualitative

The following reflects Not-for-Profit Entity A's financial assets as of the balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions 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. However, amounts already appropriated from either the donor-restricted endowment or quasi-endowment for general expenditure within one year of the balance sheet date have not been subtracted as unavailable.

Increased Disclosures surrounding Liquidity & Availability

Example C – Liquidity/availability note (table + paragraph format) (Continued)

Quantitative

Financial assets, at year end	$XX,XXX,XXX
Less those unavailable for general expenditures within one year, due to:	
Contractual and donor-imposed restriction:	
Donor restricted for time or purpose	(X,XXX,XXX)
Investments held in trust	(X,XXX,XXX)
Contractual limited assets (held in trust)	(X,XXX,XXX)
Board designated endowment funds used primarily for long term investing	(X,XXX,XXX)
Financial assets available within one year to meet cash needs for general expenditures within one year	$X,XXX,XXX

Increased Disclosures surrounding Liquidity & Availability

Example C – Liquidity/availability note (table + paragraph format) (continued)

Qualitative

Not-for-Profit Entity A is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, NFP A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of NFP A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, NFP A invests cash in excess of daily requirements 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, 20X1. There is a fund established by the governing board that may 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. 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.

Liquidity and Availability Disclosure – HUD Property Example

The Organization has $7,500 of financial assets available within one year of the statement of financial position date to meet cash needs for general expenditures, consisting of cash of $5,000 and accounts receivable of $2,500. None of these amounts are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the statement of financial position.

The Organization manages liquidity needed for operations primarily through budgeted monthly cash inflows and outflows. Cash inflows can be easily predicted since they are comprised mostly of rent and subsidy receipts. Cash outflows are planned accordingly so as not to exceed those expected inflows. A minimal amount of excess cash is on hand in the event of unexpected outflows. In addition, the Organization maintains funds in a reserve for replacement for planned property improvements, and may be used only with the approval of HUD.

Expense Classification

What is functional expense classification?

Functional expense classification, defined:

- A method of grouping expenses according to the purpose for which costs are incurred.
- The primary functional classifications of a not-for-profit entity are:
  - Program services; and
  - Supporting activities
    - Fundraising
    - Management and general
    - Membership development

What about natural classification?

Natural expense classification, defined:

- A method of grouping expenses according to the kinds of economic benefits received in incurring those expenses.
- Examples of natural expense classifications include:
  - Salaries and wages;
  - Employee benefits;
  - Professional services;
  - Supplies;
  - Interest expense;
  - Rent;
  - Utilities;
  - Depreciation.

Program services

Program services, defined:

- Activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists.
- Those services are the major purpose for and the major output of the NFP and often relate to several major programs.

M&G expenses

Definition of Management and General Activities:

- Old Definition:
  - Activities that are not identifiable with a single program, fundraising activity, or membership-development activities but that are indispensable to the conduct of those activities and an entity's existence
- New Definition:
  - Supporting activities that are not DIRECTLY identifiable with one or more program, fundraising or membership development activities
- Impact: could reduce amounts allocated to Program Costs

M&G expenses

- Costs incurred in Management and General that represent either:
  - DIRECT conduct
  - DIRECT supervision of program, fundraising, or membership development <u>must</u> be allocated from M&G to appropriate functional area

- All other costs must remain in M&G

M&G expenses

Certain items must remain in M&G (can't allocate to program and fundraising):

- General recordkeeping and payroll
  - Finance (CFO/Accounting)
  - Including grant accountants, billing, AR, payroll, audit costs, etc.
- Human resources
- Budgeting
- Oversight functions
- Business management

M&G expenses

Certain items must remain in M&G (can't allocate to program and fundraising):

- Soliciting funds other than contributions and membership dues, for example, costs associated with:
  - Promoting the sale of goods or services to customers, including advertising costs
  - Responding to, government, foundation, and other requests for proposals for customer-sponsored contracts for goods and services
- Administering government, foundation, and similar customer-sponsored contracts, including billing and collecting fees and grant and contract financial reporting
- Disseminating information to inform the public of the NFP's stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report

Common questions

- Can I still allocate interest expense?
- Can janitorial services be allocated to program?
- Where does bad debt expense go?
- My medical billing team is currently charged to the program. Will that be allowed under the new standard?
- Do I HAVE to allocate expenses out of M&G?
- If I can charge an administrative expense to a grant, shouldn't it be considered a program expense?
- How will this impact my Form 990?

Functional allocation

Functional allocation

- Each natural expense has to be allocated into one or more functional categories.
- No bright-line definition as to the number of functional expense categories to be used
- May require changes to FY2018 allocations for disclosure in FY2019 financial statements when adopting (to be comparative)

Functional allocation

Functional allocation

- Methodologies used to allocate between functions
  - Direct allocation
  - Indirect allocation
- Must have documentation to support the allocation methodology

Functional allocation

Allocation of salary and wages

- First – NFP should understand and document the responsibilities of each position
  - At smaller NFPs, the CFO may have more responsibility than finance. All the finance objectives must remain in Management & General.
  - Any time spent directly conducting or supervising program services can be allocated to Program.
- Second – Use of appropriate allocation methods and that the methods are reasonable and consistently applied
- Third – Maintain documentation to support allocation (FASB does not define how this should be done)

Functional allocation

Presentation of expenses by nature and function statement of activities

- On the face of statement of activities
- Separate statement of functional expenses
- Schedule within the notes to the financial statements

Footnote of functional expense

Footnote matrix example:

	Program Activities		Supporting Activities			Total Expenses
	Program A	Program B	Management & General	Fundraising	Membership Development	
Salaries & Benefits						
Grants to Others						
Occupancy Cost						
Contracted Services						
Supplies						
Depreciation						
Total						

*By function is across the columns and by nature is down the left rows

Statement of functional expenses

Statement of functional expense example:

BIG NATIONAL CHARITY, INC.
STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 20XX AND 20XX

	20XX			
	Animal Services	Management and General	Fundraising	Total
Grants	$ 1,617,000	$ 105,000	$ -	$ 1,722,000
Salaries and benefits	1,285,000	16,000	531,000	1,832,000
Education and awareness	706,000	54,000	245,000	1,005,000
Occupancy	203,000	30,000	72,000	305,000
Professional services	120,000	48,000	45,000	213,000
Printing	137,000	1,000	74,000	212,000
Information technologies	15,000	4,000	35,000	54,000
Travel	79,000	1,000	11,000	91,000
Depreciation	44,000	6,000	13,000	63,000
Other	80,000	18,000	113,000	211,000
	$ 4,286,000	$ 283,000	$ 1,139,000	$ 5,708,000

Statement of activities

On the face of the statement of activities example:

Expenses:	
Grant activities -	
Grants	12,125
Salaries, benefits and taxes	1,808
Occupancy costs	970
Depreciation	845
Supplies	1,255
Other	56
	17,059
Management and general -	
Salaries, benefits and taxes	452
Occupancy costs	243
Depreciation	211
Supplies	314
Other	14
	1,234
Total expenses	18,293

Functional expense disclosures

Disclosures for expense classification

- A description of the methods used to allocate costs among program and support functions

Functional expense disclosures

Policy Note:

- Note X. 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 CEO's compensation, communications department, and information technology department. Depreciation is allocated based on square footage, the CEO's compensation 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.

Functional Expense Disclosures

Policy note example:

Functional expenses – The costs of providing program and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among animal services and supporting services benefited. Such allocations are determined by management on an equitable basis.

The expenses that are allocated include the following:

Expense	Method of Allocation
Grants	Time and effort
Salaries and benefits	Time and effort
Education and awareness	Time and effort
Occupancy	Square Footage
Professional services	Full Time Equivalent
Printing	Full Time Equivalent
Information technologies	Full Time Equivalent
Travel	Time and effort
Depreciation	Square Footage
Other	Time and effort

What auditors will look at

Risk of material misstatement

- Could be significant motivation for a NFP to manipulate the financial statements and overstating program expense

- Driven by users of the FS, who place importance on the level of program expenditures:
  - Donors
  - Charity-rating organizations
  - Grantors
  - Other stakeholders

What auditors will look at

- Obtain an understanding of the NFP's :
  - Controls and processes over capturing and allocating costs among the various functions
  - Management and those charged with governance view the importance of the functional expense presentation

- Understand:
  - Skills and knowledge of NFP employee involved with the cost allocation process
  - What functional allocation pressures exist for the organization
  - Where there may be motivation to manipulate the allocation
    - Example - does the NFP advertise a targeted minimum percentage of the expense that will be program-related

What auditors will look at

Example procedures:

- Reviewing board and committee meeting minutes
- Interviewing key employees, both inside and outside the finance office, including a discussion on the types of activities they perform in support of programs, administration, and fundraising activities
- Review the allocation methods and key inputs
- Analytical procedure comparing the amounts reported to the prior year

What auditors will look at

Example procedures:

- Reviewing the organization's strategic plan, long-term budget, or annual donor report for information related to changes in programs, special events, or other key activities that may be expected to affect the functional expense presentation
- Reviewing changes in organizational structure or job duties during the year that might affect expense allocation methods

What auditors will look at

Example procedures:

- When auditing NFPs with large personnel expenses, more focused procedures on the allocation of employee time between functions may be warranted.
  - Interview key personnel about their job responsibilities or a review of job descriptions compared to the payroll cost allocation
  - Perform detailed testing of personnel allocations, including a review of timesheets or other evidence of personnel activity, to obtain appropriate audit evidence supporting the allocation

What auditors will look at

Common misstatements:

- Improper use of net vs. gross reporting
  - Example: reporting common discounts as expenses instead of netting them with revenue or failing to functionalize expenses that are netted against "special events" revenue on the statement of activities
- Failure to properly apply FASB guidance on allocating joint costs of certain solicitations that support both program services and fundraising or management activities
- Failure to identify and allocate costs of time spent by program employees on fundraising and management activities

What can you do?

- Speak with an audit firm and review FASB information
- Make sure you understand what the changes mean to your organization
- Educate your leadership team, board, and your employees

Functional Expenses Disclosure

The Organization provides low-income housing to its tenants. Expenses related to providing these services are a follows:

			2018
Program Services:			
	Administrative Expenses		$ 12,000
	Utilities Expenses		21,000
	Operating & Maintenance Expenses		27,000
	Taxes & Insurance		40,000
	Financial Expenses		48,000
	NH/Assisted Living Data		56,000
	Depreciation & Amortization		92,000
		Total program services	$ 296,000
Support services - Management and general activities:			
	Administrative Expenses		$ 8,000
	Depreciation & Amortization		7,000
	Corporate or Mortgagor Expenses		9,000
		Total support services - Management and general activities	$ 24,000
		Total	$ 320,000

Functional Expense – HUD Properties

Expenses likely or required to be M&G:

- Conventions and meetings
- Management consultants
- Management fee
- Legal expense
- Audit expense
- Bookkeeping fees/accounting services
- Bad debts
- Miscellaneous administrative expense (depends on what this includes)
- Amortization expense
- All components of corporate or mortgagor expenses (7000's in the HUD Chart of Accounts)

Other Changes

Other Changes

- Presentation of operating cash flows
  - Option to present operating cash flows using either direct method or indirect method
  - Removes requirement to present or disclose the indirect method reconciliation when using the direct method of reporting cash flows (REAC removed as well)

- Investment income
  - Requires reporting of investment return net of external and direct internal investment expenses
  - No longer requires disclosures of netted expenses

- Long-lived assets
  - Requirement to release donor restrictions that are for the acquisition or construction of long-lived assets when the asset is placed-in-service
  - Eliminates the option to release the restriction over time as the asset is depreciated

Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made

ASU 2018-08

Scope and effective date

Scope

FASB ASU No. 2018-18 – Not-for-Profit Entities (Topic 958) Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made

- Issued June 2018
- Why issued?
  - Topic 606 Revenue from Contracts with Customers issued and increased focus on revenue recognition
    - Note: if transaction is deemed "contribution" under Topic 958, it is not subject to Topic 606
  - Difficulty in characterizing grants and similar contracts with other organizations (resource providers):
    - As either exchange transactions or contributions, and
    - In determining whether a contribution was conditional

Scope

- Applies to **all entities** that receive or make contributions
  - Includes NFPS and Business Entities

- **Excludes** transfers of assets from the government to business entities

- Applies to **both**:
  - Contributions received by a recipient; and
  - Contributions made by a resource provider

- The labeling/term used to described the revenue source in the financial statements (i.e. contributions, grants, contracts, etc.) is NOT a factor in determining whether an agreement is within the scope of this guidance

Effective date

Resource Recipients		Resource Providers	
Fiscal years and interim periods beginning after June 15, 2018 for: • Public Business Entities • NFP that has issued, or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or over-the-counter market	Fiscal years beginning after December 15, 2018, and interim periods beginning after December 15, 2019 for: • All other entities	Fiscal years and interim periods beginning after December 15, 2018 for: • Public Business Entities • NFP that has issued, or is a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or over-the-counter market	Fiscal years beginning after December 15, 2019, and interim periods beginning after December 15, 2020 for: • All other entities

Transition method

Modified Prospective

- Apply to all agreements:
  - Existing at the effective date, but only to the portion of existing agreements not previously recognized
  - Entered into after the effective date.
- No restatement of prior amounts required
- However, retrospective application is permitted

Exchange vs. contribution

Exchange vs. contribution

ASU clarifies existing guidance used to determine if a transaction is a reciprocal ("exchange") or a nonreciprocal ("contribution") transaction.

- Exchange transactions are those that:
  - Provide direct commensurate value to the government/resource provider
    - Reciprocal meaning the benefits of the contract go directly back to the resource provider
  - The government/resource provider is a 3rd party payer on behalf of an identified customer (i.e. Medicaid and Medicare)

Exchange vs. contribution

ASU clarifies existing guidance used to determine if a transaction is a reciprocal ("exchange") or a nonreciprocal ("contribution") transaction.

- Non-exchange transactions are those that:
  - Provide the primary benefit to the general public or to another 3rd party entity other than the government/resource provider.

Exchange vs. contribution

Key Clarifications:

- Government/resource provider is **not** synonymous with general public, even if the resource provider is a governmental entity.
  - If resource provider received indirect value through a benefit to society or general public, it is a contribution
  - A resource provider's intent to further its mission does not constitute an exchange of commensurate value
- If primary beneficiary is 3rd party, resource recipient must use judgment to determine if it is exchange or contribution
  - Key factor: is the 3rd party specifically identified?
- Type of resource provider should not override substance of the transaction

Example 1: Exchange vs. contribution

Grant to NFP A from federal government

- Facts
  - The federal government grants $1M to NFP A to perform research on a new vaccine.
  - NFP A retains all the rights to the research and findings.

- Would this be considered an exchange transaction or a contribution?

Example 2: Exchange vs. contribution

Grant to NFP B from federal government

- Facts
  - The federal government grants $1M to NFP B to perform research on a defense technology.
  - The government retains all the rights to the research and findings.

- Would this be considered an exchange transaction or a contribution?

Example 3: Exchange vs. contribution

Grant to NFP C from state government

- Facts
  - The state government provides funding to NFP C to provide job training to low-income residents.
  - The state used to provide job training to low-income residents itself.

- Would this be considered an exchange transaction or a contribution?

Exchange vs. contribution

If transaction is a an exchange transaction

- Next step is to follow Topic 606 Revenue from Contracts from Customers

If transaction is a contribution

- Next step is to determine if there is a condition

Conditional vs. unconditional

Conditional vs. unconditional

The ASU provides new criteria for a contribution to be considered conditional

- A contribution is **conditional** if BOTH of the following are met:
  - A right of return/right of release must exist; **and**
  - The agreement must include a barrier the recipient must overcome to be entitled to the resources;

Conditional vs. unconditional

Right of Return/Right of Release

- Must be explicit in the agreement or communicated in another document referenced by the agreement.
- Implied rights of return/rights of release do not meet the criteria for conditional contributions

Conditional vs. unconditional

Indicators that a barrier exists:

- Inclusion of a measurable performance-related barrier or other measurable barrier
- Extent to which a stipulation limits discretion by recipient on the conduct of an activity
- Extent to which a stipulation is related to the purpose of the agreement

Conditional vs. unconditional

Measurable Performance-Related or Other Measurable Barrier:

- Examples of measurable performance-related barriers:
  - Specified level of service
    - 1000 meals per week
    - 250 low-income participants
  - Specific output or outcome
    - Decline in drop-out rates
    - Students achieving minimum standardized test scores

- Examples of other measurable barriers:
  - Matching contribution requirement
  - Occurrence of an outside event

Conditional vs. unconditional

Limited Discretion on the Conduct of an Activity Barriers -

- Examples include:
  - Requirement to incur only qualifying expenses that are based on specific requirements
    - Reimbursement based grants
  - Requirement to hire specific individuals as part of the workforce
  - Specific protocol that must be adhered to

Conditional vs. unconditional

Related to the Purpose of the Agreement Barriers

- Stipulation is related to the purpose of the agreement
  - *Excludes* trivial or administrative stipulations

- Examples:
  - A report conveying the specific research findings on a grant for basic research: IS related to the purpose of the agreement (considered a barrier)
  - A report showing how grant money was spent: is NOT related to the purpose of the agreement (not considered a barrier)
  - A requirement to submit an annual report or annual audit: is NOT related to the purpose of the agreement (not considered a barrier)

Example 1: Conditional vs. unconditional

Contribution by Foundation A

- Facts
  - NFP D's mission is to provide research and studies on public policy within the state
  - Foundation A provides NFP D with a $1m grant to research statistics on children in the state and produce a report on the result to be published publicly
  - Grant agreement includes a right of return as part of the foundation's standard wording
  - Grant agreement requires a report to be filed at the end of the grant summarizing how the funding was spent

- Would this be considered a conditional or unconditional contribution?

Example 2: Conditional vs. unconditional

Contribution by federal government

- Facts
  - The federal government grants $1M to NFP A to perform research on a new vaccine.
  - NFP A retains all the rights to the research and findings.
  - The terms of the grant specify that the NFP must incur certain qualifying expenses in compliance with Uniform Guidance issued by the Office of Management & Budget (OMB)
  - The grant is paid on a cost-reimbursement basis by initiating drawdowns
  - Any unused assets are forfeited, and any unallowable costs drawn down are required to be refunded.

- Would this be considered a conditional or unconditional contribution?

Example 3: Conditional vs. unconditional

Contribution by individual donor

- Facts
  - NFP E receives $1m promise to be paid over 5 years for a new wing to the NFP's building
  - The agreement includes specific building requirements, including square footage and the new wing must be environmentally friendly.
  - First installment will not be paid until NFP E submits the architectural designs to the donor. Additional installments will be paid in specified increments based upon other milestones.
  - If a milestone is not achieved, the donor is released from its promise to pay.

- Would this be considered a conditional or unconditional contribution?

Disclosures

Disclosures

Resource recipients

- No new disclosures (but you may still have changes!)
- ASC 958 provides guidance on disclosures for unconditional and conditional promises to give
- Existing disclosures for conditional promises to give may now need to be applied to additional sources of revenue (such as government grants), including:
  - The total of the amounts promised
  - A description and amount for each group of promises having similar characteristics

Disclosures

Resource providers

- No new disclosures
- Certain disclosures in ASC 450, Contingencies and ASC 470, Debt, may apply
- Must provide information about unconditional promises to give.

Q&A

Single Audit Update

Overview

- **Uniform Guidance (UG)**
  - **UG Effective Dates**
  - **Procurement update**
  - **Single Audit under UG - Refresher**
- **2018 Yellow Book**
  - **Key dates**
  - **New under 2018 Yellow Book**
- **FAC Updates**
- **Test your Knowledge**

Uniform Guidance – Effective Dates and Procurement

Uniform Guidance – Effective Dates

1. Audit requirements – In effect with NO exception (unless you are working on a June 30, 2015 or earlier audit)
2. Administrative requirements and Cost Principles
   - Apply to new awards and to additional funding (funding increments) to existing awards made after December 26, 2014.
   - Most grants are now under UG; however use **CAUTION** as our clients could STILL be spending down funds under the pre-UG rules.
   - Procurement Requirements
     - ONLY administrative requirement that non-federal entities could defer to adopt
     - Deferment period of 3 years ends in 2018

Procurement – Exception

Procurement

- Grace period option delays applicability of UG sections 200.317 to 200.326
- Three full fiscal year deferment available after December 26, 2014
  - December 31 year ends – **go live** 1/1/2018
  - March 30th year ends - **go live** 4/1/2018
  - June 30th year ends – **go live** 7/1/2018
  - September 30th year ends – **go live** 10/1/2018

What Do UG Procurement Requirements Apply to?

Goods and services charged to:

- ✗ nonfederal program
- ✗ Indirect cost pool
- ✓ federal award

Source: COFAR FAQ .320-5

UG Procurement Methods § 200.320

Method	Dollar Threshold
Micro-purchase	Not-to-exceed micro-purchase threshold Originally, this threshold was $3,000 which was subsequently increased $3,500.
Small purchase procedure	Greater than micro-purchase, not-to-exceed Simplified Acquisition Threshold (SAT) which was set at $150,000
Sealed bid	Greater than SAT
Competitive proposal	Greater than SAT
Noncompetitive proposal	Greater than micro-purchase

Single Audit under UG - Refresher

	Single Audit Rules	Old A-133 Rules
Single audit threshold	• $750,000	$500,000
Low risk auditee	• Financial statement opinion could be on the basis of accounting required by state law • Unmodified SEFA opinion • No material weaknesses at the basic FS level or federal programs • No modified opinion on compliance • No questioned costs that exceed 5% • Timely filing with the clearing house • No going concern opinion	• Unmodified opinion on basic FS in accordance with GAAP • Unmodified SEFA opinion • No material weaknesses at the basic FS level or federal programs • No material non compliance • No questioned costs that exceed 5% • Timely filing with the clearing house
Coverage requirement	• Low risk – 20% • Not low risk – 40%	• Low risk – 25% • Not low risk – 50%

Single Audit under UG - Refresher

	Single Audit Rules	Old A-133Rules
Type A threshold	• **$750,000**	• $300,000
Risk assessment for Type A's (2 year lookback)	• Material weakness • Modified opinion • Questioned costs over 5%	• Sig deficiency OR material weakness • Noncompliance condition reported
Question costs reporting threshold	• **$25,000**	• $10,000
SEFA	• Report subrecipient awards and non-cash assistance, by grant, on the FACE of the SEFA (totals by grant) and no longer footnote	• Subrecipient awards and non-cash assistance are NOT required to be reported on the FACE of the SEFA. Typically reported in the footnotes.
SSPAF/Corrective Action Plan	• Required for BOTH Section II and Section III findings	• Required ONLY for Section III findings
Audit due dates	• NO extensions allowed	• Extensions allowed

2018 Yellow Book

Key Dates

1. Final standard was issued in July 2018 – supersedes the following:
   - **2011 YB**
   - **2005 GAO CPE Guidance**
   - **2014 GAO peer review ratings guidance**

2. Effective dates:
   - **For financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020**
   - **For performance audits beginning on or after July 1, 2019**

3. EARLY IMPLEMENTATION IS **NOT** PERMITTED

When does the Yellow Book apply?

Audit requirement	GAGAS applicable?
Single Audit	Yes
HUD Consolidated Audit Guide	Yes
U.S. Department of Education Proprietary School Audit Guide	Yes
Financial statement audit of a GASB reporting entity	Maybe
Agreed upon procedures engagement on grant compliance	Maybe

Summary of key change areas from the 2011 Yellow Book

- New format and organization
- Independence requirements related to non-audit services
- CPE
- Peer review
- Finding guidance
- Waste and abuse

New format organization

Presented in a “clarified” format

- Requirements appear in boxes
- Application guidance included after each boxed requirement

Chapters are reorganized and realigned

- Certain topic areas that had previously been combined are now separated out resulting in 9 chapters

Supplemental guidance in Appendices from the 2011 YB is either removed or incorporated into 2018 YB

Auditor responsibility under Yellow Book

Unconditional requirements – auditor "must" comply with where relevant; identified with use of "must"

Presumptively mandatory requirements – auditor must comply with, except in rare circumstances; identified with use of "should"

- Departures require performance of alternative procedures and documentation justification

Application guidance – provides further explanation of the requirements and guidance for applying them; identified with "may," "might," and "could."

Independence changes

- Most significant changes relate to performance of non-audit services that include preparing accounting records and financial statements

- 2018 YB retains much of its other independence requirements and guidance

Independence

Independence threats related to preparing accounting records and F/S

2018 YB indicates that non-audit services in this area fall into three categories:

- Those that automatically impair independence
- Those that are significant threats
- Those that are threats

Independence

Activities that impair independence - preparing accounting records and F/S

- Determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;
- Authorizing or approving the entity's transactions; and
- Preparing or making changes to source documents without management approval
- Auditors should conclude that preparing F/S in their entirety from a client-provided trial balance or underlying accounting records creates significant threats

Independence

Factors evaluating significance of threats – preparing accounting records and F/S:

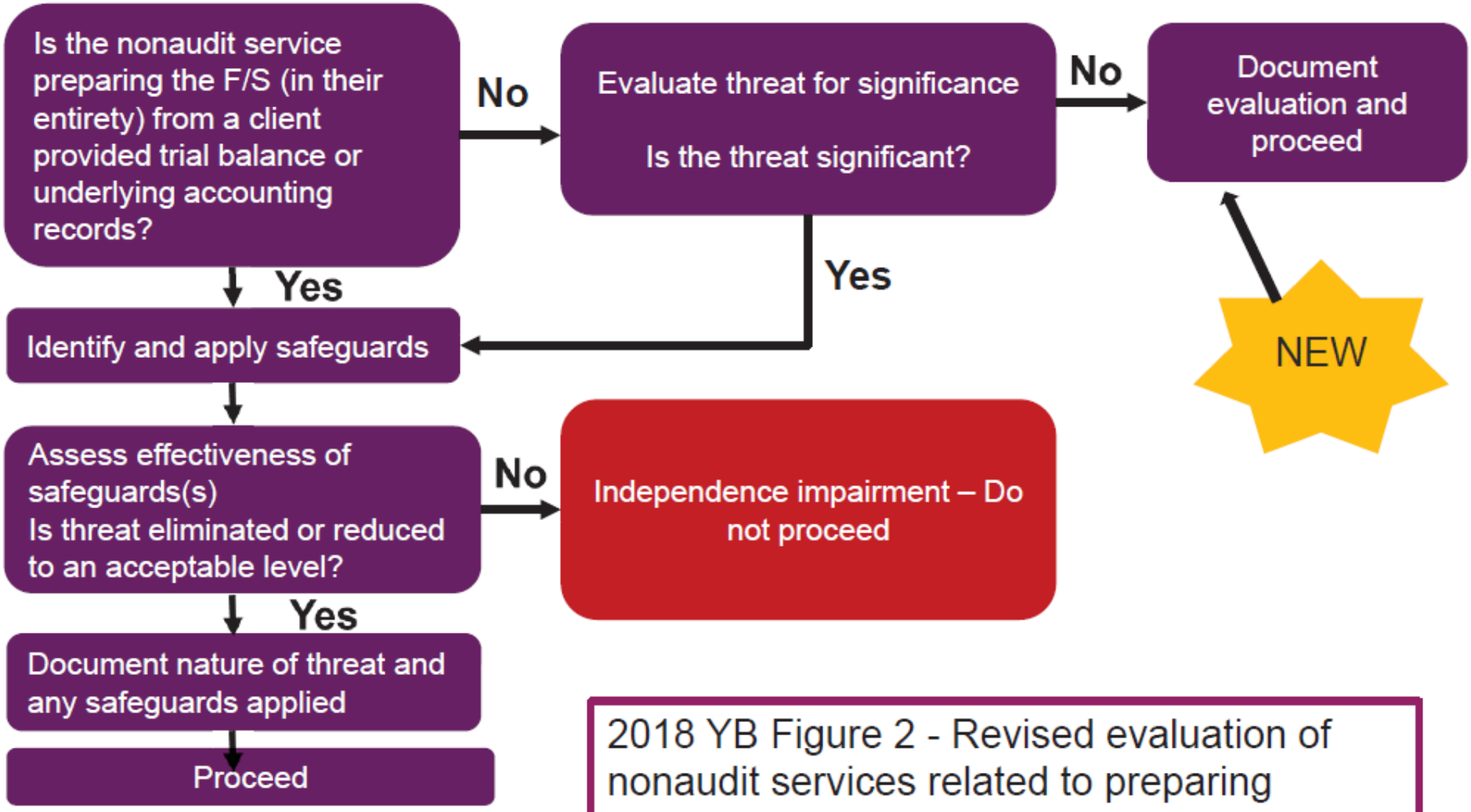
Extent outcome could have material effect on F/S

Degree of subjectivity in determining amounts or treatment

Extent of entity's involvement in determining significant matters of judgment

document
your evaluation of the significance of a threat created by preparing

Independence - revised evaluation of non-audit services



2018 YB Figure 2 - Revised evaluation of nonaudit services related to preparing accounting records and F/S

CPE requirements

2018 YB **does not** include a 4-hour GAGAS qualification CPE requirement that had been proposed in the ED

- Instead, added application guidance related to obtaining GAGAS specific

More emphasis that audit organization have responsibility for:

- assigning competent auditors
- ensuring collective competence of auditors conducting the engagement before beginning work on the engagement
- having processes so that workforce has essential knowledge, skills and abilities
- maintaining documentation of each auditor's CPE

New exception to the YB CPE hour requirement for nonsupervisory auditors charging less than 40 hours annually to YB audits (YB paragraph 4.26)

Findings

Findings – new requirement and application guidance for developing "cause" element

New Requirement: Auditors should consider internal control deficiencies in their evaluation of identified findings when developing the cause element (YB paragraphs 6.18 and 7.20)

New Application Guidance: Considering internal control in the context of a comprehensive internal control framework, such as Standards for Internal Control in the Federal Government or Internal Control—Integrated Framework, can help auditors to determine whether underlying internal control deficiencies exist as the root cause of findings. Identifying these deficiencies can help provide the basis for developing meaningful recommendations for corrective actions. (YB paragraphs 6.30 and 7.32)

Waste and abuse

2011 YB includes a “trip across” requirement to report abuse when an auditor becomes aware of it

2018 YB transitions the discussion of abuse, along with a new concept of waste, to application guidance related to findings

Waste and abuse

New Application Guidance:

- Evaluating internal control in a government environment may also include considering internal control deficiencies that result in waste or abuse.
- Because the determination of waste and abuse is subjective, auditors are not required to perform specific procedures to detect waste or abuse in financial audits.
- However, auditors may consider whether and how to communicate such matters if they become aware of them.
- Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Waste definition and examples

Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

The following are examples of waste, depending on the facts and circumstances (these examples are from the 2018 Yellow Book) :

- Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.
- Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive

FAC Updates

Federal Audit Clearinghouse

Nothing new for 2018 audits

FAC has proposed a new DCF for use in 2019, 2020 and 2021 (See GAQC Alert #358)

- Access proposed draft DCF and instructions
- Access Federal Register Notice

Resources

Resources

1. Uniform Guidance – 2 CFR 200 ecfr

https://www.ecfr.gov/cgi-bin/text-idx?tpl=/ecfrbrowse/Title02/2cfr200_main_02.tpl

2. OMB memorandum – M-18-18

https://www.whitehouse.gov/wp-content/uploads/2018/06/M-18-18.pdf

3. Yellow Book – Available on GAO's website

https://www.gao.gov/yellowbook/overview

TD5

Slide 120

TD5 Add link to GAQC Alert?

Toni Diprizio, 11/19/2018

Q&A