

# Not-for-Profit Year-End Accounting Update

## *A road map to upcoming changes*

December 5, 2017

# Housekeeping

---

- All phones will be automatically muted upon entering the meeting. Please also place your phone on mute if that feature is available to you.
- WebEx technical support can be reached at +1 800 508 8758, or you can press \*0 to speak with an operator.
- Please submit questions through the Q&A function on your screen. Questions will be addressed at the end of the presentation.
- To download a copy of the presentation, click File > Save As > Document, and select PDF as the file type.



# CPE Details

---

## CPE Credit

- Log in individually to the WebEx session
- Successfully complete three of the four polling questions



## No CPE Credit

- Fail to successfully complete three of the four polling questions
- Viewing a recording of this session (CPE is only awarded for live sessions)

## Your feedback is important

- Evaluations
- Sent within 48 hours

## Upon completion of this program, you will receive

- CPE certificate of completion
- Emailed within two weeks upon successfully passing this program

# Today's Presenters

---



**Pete Ugo**

Partner

*Not-for-profit and Higher Education Audit*



**Jennifer Richards**

Senior Manager

*Not-for-profit and Higher Education Audit*

# Agenda and Session Goals

---

- Overview of the following new Accounting Standards Updates (“ASU”)
  - Going Concern (ASU 2014-15)
  - Net Asset Value /Fair Value Measurement (ASU 2015-07)
  - Presentation of Not-for-profit (NFP) Financial Statements (ASU 2016-14)
  - Revenue from Contracts with Customers (ASU 2014-09 and follow-up ASUs)
  - Leases (ASU 2016-02)
- After today’s presentation you should be able to:
  - Identify the key content of each of the above ASUs
  - Understand how these ASUs affect your organization
  - Understand the required implementation timing of each ASU
  - Take away ideas for how to prepare for implementation

# First Polling Question



---

How would you describe your level of familiarity with the Updates listed on the previous slide?

- A. I have a basic understanding of these Updates but haven't dug into all the details yet.
- B. I generally know how these Updates will affect my organization but don't have a plan for implementation yet.
- C. I have implemented some of the Updates but am less certain on ones I have not adopted yet.
- D. I know how these Updates will affect my organization and have a plan for implementation.
- E. These Updates are all new to me.

# Implementation Dates

---

Accounting Standards Update	Effective Date - Dec 31 year-end	Effective Date – Fiscal year-end
2014-15 (Going Concern)	December 31, 2016	2017 (ie, 6/30/17)
2015-07 (Net Asset Value)	December 31, 2017**	2018 (ie, 6/30/18)**
2016-14 (Presentation of NFP Financial Statements)	December 31, 2018	2019 (ie, 6/30/19)
2014-09 and follow-up ASUs (Revenue From Contracts with Customers)	December 31, 2019 **	2020 (ie, 6/30/20)**
ASU 2016-02 (Leases)	December 31, 2020**	2021 (ie, 6/30/21)**

\*\*Note that NFPs that are conduit debt obligors must implement these Updates one year earlier.

# Deeper Dive Into ASU 2014-15 (Going Concern)

## Summary of Provisions

Single threshold model similar in principle to **current auditing standards (AU 341)**.

Disclosures required when there is **substantial doubt**, or when...

...substantial doubt has been **alleviated** primarily by management plans.

Substantial doubt exists when it is **probable** that entity will not meet obligations...

...for a period of **one year from the financial statement issuance date**.

Effective Date: 12/31/2016 YE or FY 2017

- Early adoption is permitted

# Deeper Dive Into ASU 2015-07 (Fair Value and NAV)

---

- Eliminates the requirement to categorize investments measured using the NAV practical expedient in the fair value hierarchy table
- Disclose the FV of investments using the NAV practical expedient separate from the FV table so that it reconciles to the Statement of Net Assets
- Eliminates certain disclosures for assets that are eligible for NAV practical expedient, but do not use the NAV practical expedient

## Effective Date:

- Non-Public Business Entities: 12/31/2017 YE or FY 2018
- Early adoption permitted



# Deeper Dive Into ASU 2015-07 (Fair Value and NAV)

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>
<b>Assets</b>					
Securities					
Short-term investments	\$ 55,778,281	\$ 55,778,281	\$ -	\$ -	\$ -
Government securities	19,745,263	19,745,263			
Corporate bonds	14,622,022	139,763	14,482,259		
Domestic common stocks	113,688,022	64,759,015	-	-	48,929,007
Foreign common stocks	109,171,252	12,534,222	-	-	96,637,030
Total securities	313,004,840	152,956,544	14,482,259	-	145,566,037
Private equity					
Venture capital/buy-out	75,196,764	-	-	75,196,764	-
Special situations	6,331,889	-	-	6,331,889	-
Total private equity	81,528,653	-	-	81,528,653	-
Real assets					
Real estate	13,087,121	-	-	13,087,121	-
Natural resources	19,638,004	-	-	19,638,004	-
Total real assets	32,725,125	-	-	32,725,125	-
Diversifying assets					
Absolute return					
Strategies	1,730,260	-	-	-	1,730,260
Direct lending	4,422,521	-	-	4,422,521	-
Equity long/short	96,230,104	-	-	-	96,230,104
Global macro	239,015	-	-	-	239,015
Distressed	38,841,168	-	-	14,530,641	24,310,525
Short credit	952,375	-	-	-	952,375
Total diversifying assets	142,415,441	-	-	18,953,162	123,462,279
Other investments	629,000	-	629,000	-	-
Cash surrender value of life insurance	5,226,278	-	-	5,226,278	-
Beneficial interest in lead and remainder trusts	9,992,206	-	-	9,992,206	-
Beneficial interest in perpetual trusts	10,015,196	-	-	10,015,196	-
	<b>\$ 595,538,739</b>	<b>\$ 152,956,544</b>	<b>\$ 15,111,259</b>	<b>\$ 158,440,620</b>	<b>\$ 269,028,316</b>

# ASU 2016-14 - Presentation of NFP Financial Statements

---

- ASU 2016-14 - Issued August 18, 2016
- Effective - 12/31/2018 year-end, or FY 2019; Early adoption is permitted
- Key objectives:
  - Update, not overhaul, the current model
  - Improve net asset classifications
  - Improve information in financial statements and notes about financial performance, cash flows and liquidity
  - Better enable NFPs to “tell their financial story”

## Second Polling Question



---

Do you think that the FASB met their objectives in the final issued ASU 2016-14?

- A. Yes
- B. No
- C. It remains to be seen!

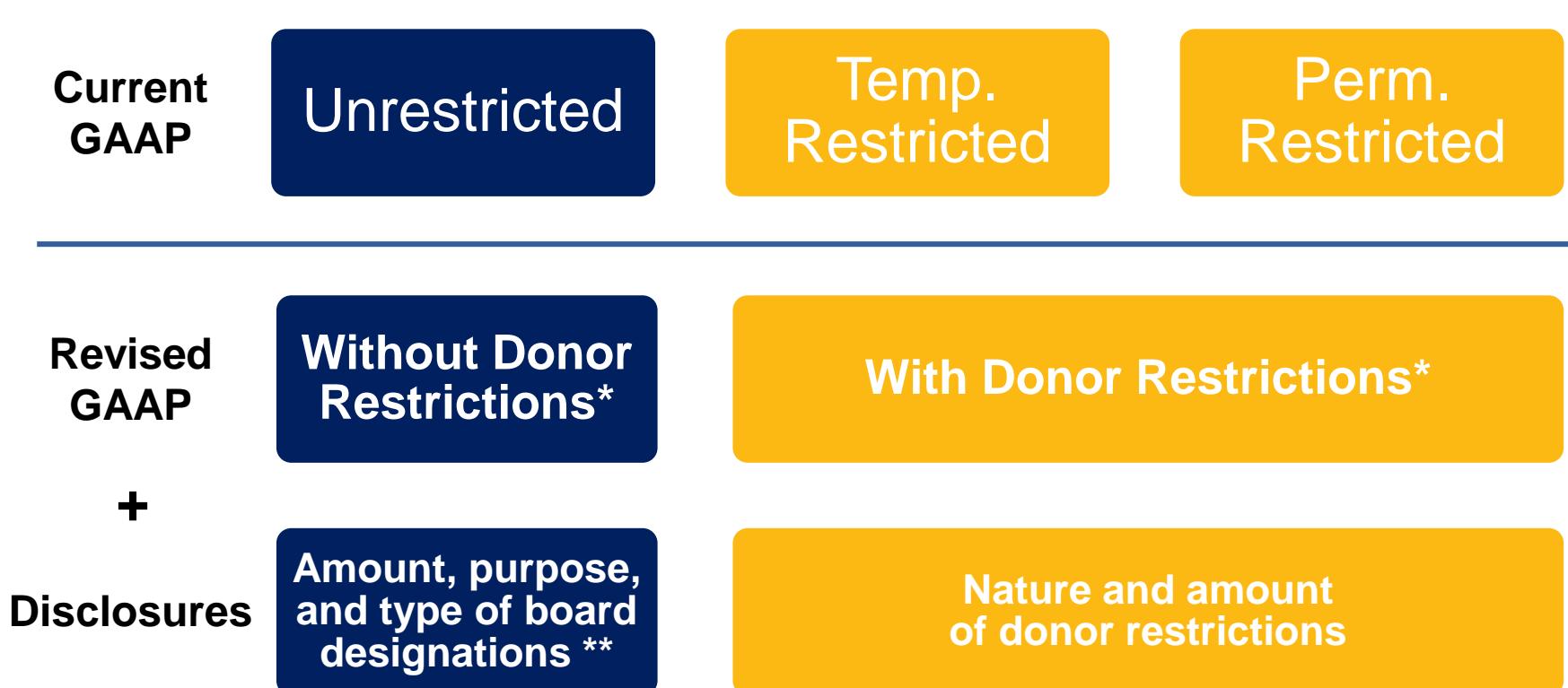
# Presentation of NFP Financial Statements (continued)

---

- Net asset classification
  - Updates the net asset presentation
  - Changes underwater endowment accounting and disclosure – potential one-time adjustment
  - Removes option for implied time restrictions on capital gifts
  - Enhances disclosures
- Liquidity & availability
  - Quantitative and qualitative disclosures about liquidity and availability of resources
    - Qualitative - how an NFP manages its liquid available resources and its liquidity risk (in the notes)
    - Quantitative - communicate 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)
    - The availability of an NFP's financial assets at the balance sheet date to meet cash needs within 1 year of the B/S date

# Net Asset Presentation (after ASU 2016-14)

---



\* NFPs may choose to disaggregate further

\*\* New disclosure requirement

# Presentation of NFP Financial Statements (continued)

---

- Net asset classification

- Moves to two categories – without donor restrictions and with donor restrictions
- New disclosures about amount, purpose and type of board designations
- Nature and amount of donor restrictions

Net Assets [The level of detail presented here is not required, however if the information presented on the face is not sufficiently detailed, it must be included in the notes.]

Without donor restrictions		
Undesignated	3,057,607	1,370,401
Designated by the Board for operating reserve	300,000	250,000
Designated by the Board for endowment	15,511,186	14,912,222
Invested in property and equipment, net of related debt	21,150,885	20,193,878
	<hr/>	<hr/>
	40,019,678	36,726,501
With donor restrictions		
Perpetual in nature	22,864,750	22,450,146
Purpose restrictions	14,228,316	10,351,233
Time-restricted for future periods	1,391,825	1,279,636
Underwater endowments	-	(42,677)
	<hr/>	<hr/>
Total net assets	38,484,891	34,038,338
Total liabilities and net assets	78,504,569	70,764,839
	<hr/>	<hr/>
	\$ 94,314,447	\$ 86,137,541

# Presentation of NFP Financial Statements (continued)

Net assets with donor restrictions are restricted for the following purposes or periods.

	20X1	20X0
<b>Subject to expenditure for specified purpose:</b>		
Building project	\$ 500,000	\$ -
Operation of the training center	448,377	108,927
Educational programs	375,627	119,290
Financial aid	146,105	85,744
<b>Promises to give, the proceeds from which have been restricted by donors for</b>		
Educational programs	57,265	-
Centennial anniversary celebration	22,847	-
	<u>1,550,221</u>	<u>313,961</u>
<b>Subject to the passage of time:</b>		
Beneficial interests in charitable trusts held by others	812,850	804,179
Assets held under split-interest agreements	558,975	440,457
<b>Promises to give that are not restricted by donors, but which are unavailable for expenditure until due</b>	<u>20,000</u>	<u>35,000</u>
	<u>1,391,825</u>	<u>1,279,636</u>
<b>Endowments:</b>		
Subject to appropriation and expenditure when a specified event occurs:		
Restricted by donors for		
Available for general use	7,223,171	5,252,329
Educational programs	4,186,393	3,761,284
Financial aid	1,268,531	1,023,659
	<u>12,678,095</u>	<u>10,037,272</u>

# Presentation of NFP Financial Statements (continued)

---

Subject to NFP endowment spending policy and appropriation:

Operation of the Training Center	6,811,531	6,726,382
Educational programs	8,279,742	8,000,578
Financial aid	1,688,411	1,686,761
General use	2,058,166	2,058,166
Unconditional promises to give, net - permanently restricted to general endowment	336,999	372,553
Underwater endowments	-	(42,677)
	<u>19,174,849</u>	<u>18,801,763</u>
<b>Total endowments</b>	<b><u>31,852,944</u></b>	<b><u>28,839,035</u></b>

Not subject to spending policy or appropriation:

Beneficial interest in assets held by community foundation	1,094,842	1,090,505
Beneficial interests in perpetual trusts	2,595,059	2,515,201
	<u>3,689,901</u>	<u>3,605,706</u>
	<b><u>\$ 38,484,891</u></b>	<b><u>\$ 34,038,338</u></b>

# Sample Liquidity Disclosure (after ASU 2016-14)

Financial assets, at year-end*	\$ 234,410
Less those available 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

# Presentation of NFP Financial Statements (continued)

---

- Liquidity & availability
  - Quantitative and qualitative disclosures about liquidity and availability of resources

## Note 2 - Liquidity and Availability

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, comprise the following:

Cash and cash equivalents	\$ 4,851,231
Accounts receivable	312,216
Operating investments	723,006
Promises to give	965,846
Distributions from assets held under split-interest agreements	145,000
Distributions from beneficial interests in assets held by others	180,110
Endowment spending-rate distributions and appropriations	<u>1,115,664</u>
	<u>\$ 8,293,073</u>

# Presentation of NFP Financial Statements (continued)

---

- Liquidity & availability
  - Quantitative and qualitative disclosures about liquidity and availability of resources

Our endowment funds consist of donor-restricted endowments and funds designated by the board as endowments. Income from donor-restricted endowments is restricted for specific purposes, with the exception of the amounts available for general use. Donor-restricted endowment funds are not available for general expenditure.

Our board-designated endowment of \$15,511,186 is subject to an annual spending rate of 4.5 percent as described in Note 9. Although we do not intend to spend from this board-designated endowment (other than amounts appropriated for general expenditure as part of our Board's annual budget approval and appropriation), these amounts could be made available if necessary.

As part of our liquidity management plan, we invest cash in excess of daily requirements in short-term investments, CDs, and money market funds. Occasionally, the Board designates a portion of any operating surplus to its operating reserve, which was \$300,000 as of December 31, 201X.

# Presentation of NFP Financial Statements (continued)

---

- Expenses
  - Requirement to report expenses by function (already required) and natural classification
  - Analysis showing the relationship between function and nature
  - Additional qualitative information about cost allocations
  - ALL NFPs must report information about all expenses in one location – on the face of the Statement of Activities, as a schedule in the notes to the financial statements, or as a separate statement. NOTE – including this as a supplemental schedule is not an option
- Statement of cash flows
  - Indirect reconciliation no longer required for direct method
  - Does not require direct method (which was in initial draft)
- Investment return
  - Present investment return net of external and direct internal investment expenses
  - No longer required to disclose netted expenses
- Phase II – To be determined
  - Operating measure

# Presentation of NFP Financial Statements (continued)

Analysis of operating expenses by nature **and** function → one place in the F/S  
(statement of activities, separate statement, or schedule in notes), with additional qualitative information about cost allocations

	Function					
	Program Activities		Supporting	Total Operating Expenses	Non-Operating	Total Expenses
	Program A	Program B	M&G			
Grants	25,000,000	25,000,000	-	50,000,000	-	50,000,000
Salaries and Benefits	2,500,000	2,500,000	2,500,000	7,500,000	-	7,500,000
Office and Occupancy	400,000	400,000	400,000	1,200,000	-	1,200,000
Information Technology	100,000	100,000	300,000	500,000	-	500,000
Board Expense	-	-	250,000	250,000	-	250,000
Supplies	15,000	15,000	20,000	50,000	-	50,000
Depreciation	50,000	50,000	150,000	250,000	-	250,000
Other	50,000	50,000	150,000	250,000	-	250,000
<b>Total</b>	<b>28,115,000</b>	<b>28,115,000</b>	<b>3,770,000</b>	<b>60,000,000</b>	<b>-</b>	<b>60,000,000</b>

# Presentation of NFP Financial Statements (continued)

---

## **Note 13 - Functionalized Expenses**

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include occupancy, depreciation, and amortization, which are allocated on a square footage basis, as well as salaries and wages, benefits, payroll taxes, professional services, office expenses, information technology, interest, insurance, and other, which are allocated on the basis of estimates of time and effort.

# Presentation of NFP Financial Statements (continued)

---

- Operating measure: Two options
  - Define specifically what is in the operating measure or
  - Start with the change in net assets without donor restrictions (old unrestricted) and say what is not included in the operating measure
  - Example “Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing asset without donor restrictions except those items with long-term investment, actuarial adjustments to self-insurance liabilities, changes in postretirement benefit obligations and changes in the fair value of the derivative instruments, and other infrequent gains and losses.”

# Presentation of NFP Financial Statements (continued)

---

- Steps to take now to plan ahead:
  - Educate financial statement users – Upper management, Board, Audit committee, etc.
  - Draft sample schedules and disclosures for review and discussion well in advance of implementation so stakeholders can have input
  - Note the following on implementation: all is retrospective to the earliest period presented EXCEPT:
    - Analysis of expenses by both natural classification and functional classification
    - Disclosures about liquidity and availability of resources.

## Third Polling Question



Which requirement from the NFP financial reporting standard do you believe will be the most complicated to address or implement?

- A. Net assets presentation
- B. Liquidity and availability calculations and disclosures
- C. Schedule of expenses by function and nature
- D. Not worried about any of it, I've got this!

# ASU 2014-09 and related amendments – Revenue Recognition

---

- Objective: to develop a single, principle-based revenue standard for generally accepted accounting principles and international financial reporting standards
- Scope: All contracts with customers, except
  - Lease contracts
  - Insurance contracts
  - Financial instruments
  - Guarantees
  - Nonmonetary exchanges in the same line of business to facilitate sales to customers
- Contracts that are not with customers are excluded
  - Contributions
  - Collaborative arrangements

# Revenue Recognition (continued)

---

- Core principle: recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services
- 5 steps to apply the core principle:
  - Identify contracts with customers
  - Identify **performance obligations**
  - Determine the **transaction price**
  - Allocate **transaction price**
  - Recognize revenue when (or as) a **performance obligation** is satisfied

# Revenue Recognition (Continued)

---

<b>Current GAAP revenue recognition guidance</b>	<b>New standards for revenue recognition</b>
1. Persuasive evidence of an arrangement exists	1. Identify the contract(s) with a customer
	2. Identify the performance obligations in the contract
2. The arrangement fee is fixed or determinable	3. Determine the transaction price
3. Delivery or performance has occurred, and	4. Allocate the transaction price to the performance obligations in the contract
	5. Recognize revenue when (or as) the entity satisfies a performance obligation
4. Collectability is reasonably assured	Is now part of Step 1

# Revenue Recognition (continued)

---

- New disclosures
- Disaggregation of revenue
  - Qualitative disaggregation of revenue into categories that depict how revenue and cash flows are affected by economic factors
- Information about contract balances **(public entities only)**
- Remaining performance obligations **(public entities only)**
- Areas of focus for NFPs discussed by the AICPA Task Forces
  - Tuition and housing fees
  - Membership dues
  - Grants
  - Project added to FASB Technical Agenda to improve and clarify existing guidance

# Revenue Recognition (continued)

---

## Possible Revenue Streams Subject to New Guidance

- *Royalty agreements*
- *Advertising*
- *Licenses*
- *Grant contracts*
- *Memberships*
- *Subscriptions*
- *Product Sales*
- *Service Revenue*
- *Sponsorships*
- *Conferences*
- *Tuition*



# Revenue Recognition (continued)

---

## **ASU 2014-09 - *Revenue from Contracts with Customers***

- Bifurcation
  - 958-605-55-2:
    - "... A grant, sponsorship, or membership may be entirely a contribution, entirely an exchange, or a combination of the two..."
  - 958-605-55-6:
    - "Moreover, a single transaction may be in part an exchange and in part a contribution... See paragraphs 958-720-45-18 through 45-19... 958-225-55-11 through 55-15 for direct benefits provided to donors at special events."

*Example* - NFP has annual dues of \$50, and the only tangible benefit members receive is an monthly newsletter with a total fair value of \$20.

# Revenue Recognition (Continued)

---

- Grants and contracts to NFPs (**Exposure Draft**)
  - Long-standing diversity in practice in classifying grants and contracts, particularly from governmental entities
- Issue 1: Reciprocal (exchange) versus nonreciprocal
  - Many NFPs treat grants and contracts with government entities as exchange transactions
  - Some equate the government with the general public – issue is whether government receives direct commensurate value in return (because the public benefits)
  - Many believe the government doesn't give contributions
- Issue 2: Conditional versus unconditional
  - Stakeholders find it difficult to distinguish between conditional and unconditional contribution causing diversity in application
  - If funds are provided with certain stipulations, there's difficulty in distinguishing whether contribution is conditional, restricted or both.
  - Diversity in application of "remote" notion – whether likelihood of failing to meet a condition is remote (Some NFPs believe any condition within their control has a remote likelihood of not being met

# Revenue Recognition (Continued)

---

- Current practice - exchange transactions can include:
  - Direct commensurate value to provider
  - Specified third parties
  - General public
- Proposed clarification - exchange transactions will include:
  - Direct commensurate value to provider
  - Specified third parties if it is a government / resource provider who is a third party payer on behalf of an identified customer
- Proposed clarification - non-exchange transactions will include:
  - Specified third parties – open as to whether a “performance obligation” could include contracts where the general public is the primary beneficiary
  - General public

# Revenue Recognition (Continued)

---

- Conditional versus unconditional contributions
  - For a donor-imposed condition to exist
    - A right of return/release must exist and
    - The agreement must include a barrier
  - Indicators to determine a barrier would include
    - Measurable performance related or other measurable barrier (specified level of services, outputs, outcomes, outside events, matching, etc.)
    - Excludes barriers unrelated to the primary purpose of the Agreement. This would exclude administrative tasks and trivial stipulations.
- Timeline:
  - Final ASU expected in early 2018

# Revenue Recognition (continued)

---

- Steps to take now to plan ahead:
  - Take inventory of the various revenue streams your organization has
  - Identify whether revenue streams qualify as contracts with customers
  - For those that fall under the revenue recognition guidance, work through the five steps to determine appropriate revenue recognition
  - Share information on the new guidance with those responsible for executing contracts. Slight changes in contracts might change the revenue recognition so it is important to keep an inventory of these and be uniform where possible
  - Document your assessment in memos, review internally, and review with your auditor

# Leases

---

- ASU 2016-02, Leases (Topic 842)
  - Issued February 2016 (effective years beginning after 12/15/2019)
  - Significant change under the new standard - Requires lessees to recognize all leases with terms greater than 12 months on their balance sheet as lease liabilities with a corresponding right-of-use asset.
  - For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

SEC estimates \$1.25 trillion in off balance sheet operating lease commitments for just SEC registrants!

# Leases (continued)

---

## Lessee Accounting Overview:

- Statement of Financial Position Impact:
  - Lessee will receive a right-of-use (ROU) asset, in exchange for lease payments to the lessor
  - Future lease payments will be presented on the balance sheet as a lease liability
- Statement of Activities Impact:
  - Lease expense on a straight-line basis
- Statement of Cash Flows Impact:
  - Cash paid for lease payments



# Leases (continued)

---

**Identifying a lease includes determining that the following are present:**

Identified Asset	Right to Control Use During Term
Explicitly or implicitly specified	Ability to obtain substantially all of the economic benefits from the use
No ability to substitute (or no benefit from substituting)	Right to direct the use of the identified asset

Most leases today will be leases under the new standard!

# Leases (continued)

---

## Criteria

- Five classification criteria (ASC 842-10-25-2) similar to existing GAAP
- No bright line thresholds
- Largely based on whether lessee obtains control of the underlying asset rather than control over merely the use of the underlying lease asset
- “Reasonably certain to exercise”
  - Lease term includes periods subject to extension options if the lessee is **Reasonably Certain** to exercise that option
  - Application of reasonably certain in the lease term assessment and consideration of options to purchase is intended to be applied similar to the existing “reasonably assured” threshold

## Related party leases

- Accounted for on the basis of legally enforceable terms and conditions stated in the lease, rather than on the basis of the lease's economic substance.

# Leases (continued)

---

	Finance Lease	Operating Lease
Has control of the lease asset passed to the lessee?	Yes	No
Balance sheet	Right-of-use asset Lease liability	Right-of-use asset Lease liability
Income statement (characterization)	Interest expense Amortization expense	Lease expense (including initial direct costs)
Pattern of expense	Front-loaded	Straight-line
Cash flow statement	Operating - cash paid for interest Financing - cash paid for principal	Operating - cash paid for lease payments

# Leases (Continued)

---

Example:

A 10 year operating lease with payments totaling \$750,000 in the amounts shown below

Year 1: FY 2016	\$ 50,000
Year 2: FY 2017	50,000
Year 3: FY 2018	50,000
Year 4: FY 2019	50,000
Year 5: FY 2020	50,000
Year 6: FY 2021	100,000
Year 7: FY 2022	100,000
Year 8: FY 2023	100,000
Year 9: FY 2024	100,000
Year 10: FY 2025	<u>100,000</u>
Total cash	\$ 750,000

Risk free rate	1.57%	Risk free rate for a 10 year T-bill at 9/1/2016
Initial lease liability	\$650,000	Calculated net present value

# Leases (Continued)

---

## Example:

A 10 year operating lease with payments totaling \$750,000 in the amounts shown below

- Debit the right of use asset \$650,000 and Credit lease liability the present value of \$650,000
- You would need to calculate a change in net present value for each year of the lease and apply the Credit to cash for payments between a Debit to the lease liability “principle” and the remainder to interest expense.
- Each year you calculate the updated present value of the liability
- Then you would record the following entries:
  - Debit straight-line rent expense \$75,000
  - Debit \$60,000 to reduce the leasehold liability (based on change in present value)
  - Credit \$50,000 for the cash payment
  - Credit accumulated amortization on the right to use asset \$85,000 (based on straight-line rent less interest on liability)

# Leases (Continued)

---

## ASSETS

### Current assets

Cash and cash equivalents	\$ 2,254,625
Prepaid expenses and other current assets	<u>189,410</u>
Total current assets	2,444,035
Property and equipment	1,434,584
Less accumulated depreciation	<u>(558,608)</u>
Property, equipment and software, net	875,976
Right to use office space	<u>2,116,000</u>
	<u><u>\$ 5,436,011</u></u>

## LIABILITIES AND NET ASSETS

### Current liabilities

Accounts payable	\$ 285,126
Lease liability for office space - short term	<u>200,000</u>
Total current liabilities	485,126
Lease liability for office space - long term	<u>1,916,000</u>
Total liabilities	2,401,126

# Leases (continued)

---

- Steps to take now to plan ahead:
  - Take an inventory of the various leases you have throughout the organization
  - This should include involving various stakeholders and maintaining a centralized location for all lease contracts
  - Pay particular attention to information technology related contracts that might at first appear to be a “license” agreement but in substance fall under the lease guidance
  - Make various stakeholders in the organization aware of the impending new lease guidance so that as new leases are entered the information can be collected
  - Assess significant leases for the potential impact in advance so that this is not a surprise when this Update is implemented
  - Make banks/lenders aware as this potentially might impact covenants
  - Note that this is required to be retrospectively adopted to the earliest date presented

## Fourth Polling Question



Of the new Updates covered today, which do you think will require the most time and effort to implement for you and your organization?

- A. Going concern
- B. Fair value / NAV
- C. NFP financial reporting
- D. Revenue recognition
- E. Leases

# Other Accounting Developments

---

- ASU 2017-07, *Compensation – Retirement Benefits (Topic 715)*: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.
  - Issued March 2017 (effective years beginning after **12/15/2018**)
    - The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments also allow only the service cost component to be eligible for capitalization when applicable (e.g., as a cost of internally manufactured inventory or a self-constructed asset). Early adoption is permitted.

# Other Accounting Developments (Continued)

---

- ASU 2017-02, *Not-for-Profit Entities—Consolidation (Subtopic 958-810)*: Clarifying When a Not-for-Profit Entity That Is a General Partner or a Limited Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity.
- Issued January 2017 (effective years beginning after **12/15/2016**) – fiscal year 2018
  - These amendments clarify when a not-for-profit entity that is a general partner or a limited partner should consolidate a for-profit limited partnership or similar legal entity once the amendments in Accounting Standards Update No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, become effective. The amendments maintain how not-for-profit general partners currently apply the consolidation guidance in Subtopic 810-20. The amendments also add to Subtopic 958-810 the general guidance in Subtopic 810-10 on when not-for-profit limited partners should consolidate a limited partnership.

# Other Accounting Developments (Continued)

---

- ASU 2016-18, *Statement of Cash Flows (Topic 230)*: Restricted Cash.
  - Issued November 2016 (effective years beginning after **12/15/2018**)
  - These amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments do not provide a definition of restricted cash or restricted cash equivalents. Early adoption is permitted.

# Other Accounting Developments (Continued)

---

- ASU 2016-15, *Statement of Cash Flows (Topic 230)*: Classification of Certain Cash Receipts and Cash Payments.
  - Issued August 2016 (effective years beginning after **12/15/2018**)
    - These amendments provide cash flow statement classification guidance for:
      - 1) Debt Prepayment or Debt Extinguishment Costs;
      - 2) Settlement of Zero-Coupon Debt Instruments or Other Debt Instruments with Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate of the Borrowing;
      - 3) Contingent Consideration Payments Made after a Business Combination;
      - 4) Proceeds from the Settlement of Insurance Claims;
      - 5) Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, including Bank-Owned Life Insurance Policies;
      - 6) Distributions Received from Equity Method Investees;
      - 7) Beneficial Interests in Securitization Transactions; and
      - 8) Separately Identifiable Cash Flows and Application of the Predominance Principle.

# Other Accounting Developments (Continued)

---

- ASU 2016-13, *Financial Instruments —Credit Losses (Topic 326)*: Measurement of Credit Losses on Financial Instruments.
  - Issued June 2016 (effective years beginning after **12/15/2020**)
  - Among other things, these amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

# Other Accounting Developments (Continued)

---

- ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10)*: Recognition and Measurement of Financial Assets and Financial Liabilities.
- Issued January 2016 (effective years beginning after **12/15/2018**)
  - The amendments in ASU 2016-01, among other things:
    - 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income;
    - 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes;
    - 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables);
    - 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost.
  - Early adoption is permitted.

# Other Accounting Developments (Continued)

---

- ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*
  - Issued July 2015 (effective years beginning after **12/15/2016**)
  - The amendments in ASU 2015-11 require an entity to measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost.

---

## For more information, contact:

**Pete Ugo, CPA, Partner**  
Crowe Horwath LLP

Phone: 317.208.2509  
email: [pete.ugo@crowehorwath.com](mailto:pete.ugo@crowehorwath.com)

**Jennifer Richards CPA, Senior Manager**  
Crowe Horwath LLP

Phone: 630.586.5256  
email: [jennifer.richards@crowehorwath.com](mailto:jennifer.richards@crowehorwath.com)