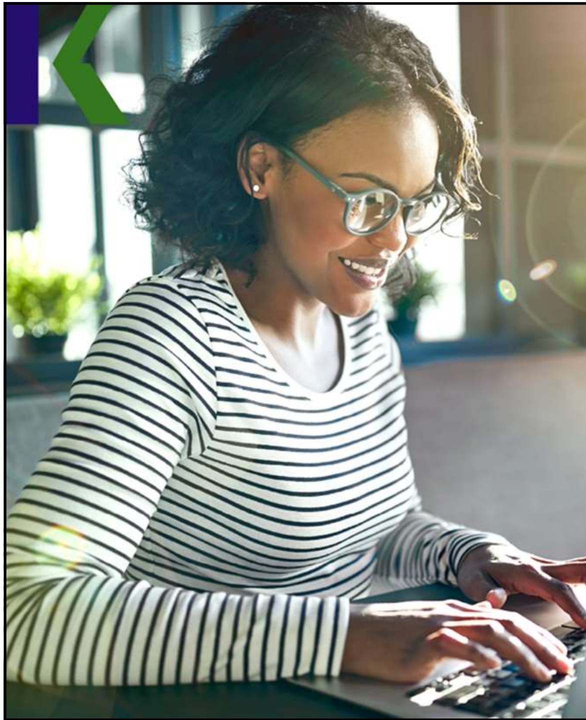
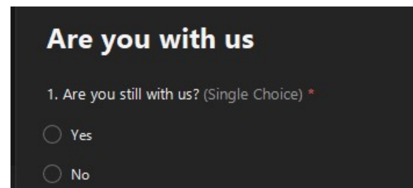


Not-for-Profit Update

(NFPU2)

Tips for a Successful Experience

- **Technical Difficulty?** Try refreshing your page, reconnecting to the class, or rebooting (chat the moderator if you do this, so they can keep track of your presence). Also, logging in under your company's VPN may cause technical difficulty. Turn off your pop up blocker! Tech Support Team 866.265.1561 Option 1 then Option 2
- **Earning CPE:** Throughout the presentation a presence manager will pop up to check your attendance. Answer the questions with the appropriate response to record your attendance. Credit is earned by acknowledging 75% of these pop-ups per hour.



- **Chats:** You may be asked to reply to the moderator in the chat box to confirm attendance. Please be aware of any chats.
- **Questions:** Use the Chat box to ask any questions you may have about today's webcast. Someone is available to assist with your technology related concerns. The instructor will address your content related questions during the presentation or follow up after.
- **Once you are logged in please do not log out even during breaks.**

Unit 1

Donations of Nonfinancial Assets

2020-07, Contributed Nonfinancial Assets

- Effective for not-for-profits for annual periods beginning after June 15, 2021.
- Retrospective application is required.
- Nonfinancial assets or services.
- FASB expressed concern that there was insufficient information in the financial statements to allow the user to assess the entity's dependence on those gifts.
- Many not-for-profits fail to value nonfinancial assets.
- Contributions are recorded at fair value at the date of donation.
- Generally, no impact on net assets.

Test Yourself Question

Which of the following is **not** an example of a nonfinancial asset?

a. Cryptocurrency

b. Buildings

c. Equipment

d. Marketable securities

Test Yourself Question, Solution

Which of the following is **not** an example of a nonfinancial asset?

a. Cryptocurrency

b. Buildings

c. Equipment

d. Marketable securities

2020-07, Contributed Nonfinancial Assets

- ASU-2020-07 is strictly a disclosure requirement.
- Prior standard required the entity to disclose information about contributed services the nature and extent of the services received for the period and the amount recognized as revenues for the period. (still required)
- The guidance encouraged the disclosure of the fair value of contributed services received but not recognized as revenue if practicable.
- Recognition of contributed services
- Not-for-profits are encouraged to disclose the fair value of contributed services received, but not recognized as revenues if that is practicable.

2020-07, Contributed Nonfinancial Assets

- The not-for-profit will present contributed nonfinancial assets in a separate line item from contributions of cash or other financial assets.

Not-for-Profit Social Service Agency	
Statement of Activities	
Year Ended June 30, 20X1	
Changes in net assets without donor restrictions	
Revenues and gains:	
Contributions of cash and other financial assets	$ 6,790
Contributions of nonfinancial assets	**1,850**
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

2020-07, Contributed Nonfinancial Assets

- ASU 2020-07 allows some leeway in presentation.
- While the information is **required** to be broken out on the **statement of activities** the captions may vary.
- FASB has noted in presentations that there could be a separate column where contributions of nonfinancial assets are listed.
- If the entity wanted to it could list the types of nonfinancial assets in the statement activities instead of in the footnotes.

2020-07, Contributed Nonfinancial Assets

Disclosure Requirement	Disclosure Requirement
• Qualitative information about whether the contributed nonfinancial assets were either monetized or utilized during the reporting period • The entity's policy for monetizing rather than utilizing contributed nonfinancial assets • If assets were utilized, a description of the programs or other activities in which those assets were used.	• Description of any related donor restrictions • Description of the valuation techniques and inputs used to arrive at a fair value measure at initial recognition. • The principal market used to arrive at a fair value measurement if it is a market in which the entity is prohibited by donor restrictions from selling or using the contributed nonfinancial asset.

Example

Contributed Nonfinancial Assets (one year presentation)

For the year ended June 30, 20X1 contributed nonfinancial assets recognized within the statement of activities (in thousands) included:

	20X1
Building	$ 1,155
Food	45
Medical supplies	172
Pharmacuticals	213
Clothing	25
Vehicles	73
Services	167
	$ 1,850

Example (con't)

The Agency recognized contributed nonfinancial assets within revenue, including a contributed building, vehicles, food, medical supplies, pharmaceuticals, clothing, and services. Unless otherwise noted, contributed nonfinancial assets did not have donor-imposed restrictions.

It is the Agency's policy to sell all contributed vehicles immediately upon receipt at auction or for salvage unless the vehicle is restricted for use in a specific program by the donor. No vehicles received during the period were restricted for use. All vehicles were sold and valued according to the actual cash proceeds on their disposition.

The contributed building will be used for general and administrative activities. In valuing the contributed building, the Agency estimated the fair value on the basis of recent comparable sales prices in the Baltimore real estate market.

Example (con't)

Contributed food was utilized in the following programs: domestic community development, and services to community shelters. Contributed clothing was used in the Agency's homeless shelter. Contributed medical supplies were utilized in the Agency's medical clinics. In food, clothing, and medical supplies, the Agency estimated the fair value on the basis of estimates of wholesale values that would be received for selling similar products in the United States.

Contributed pharmaceuticals were restricted by donors to use outside in the metropolitan Baltimore area and were utilized in programs for underserved adults and children. In valuing contributed pharmaceuticals the Agency used the Federal Upper Limit based on the weighted average of the most recently reported monthly Average Manufacturer Prices (AMP) that approximate wholesale prices in the United States (that is, the principal market).

Contributed services recognized comprise professional services from attorneys advising the Agency on various administrative legal matters. Contributed services are valued and are reported at the estimated fair value in the financial statements based on current rates for similar legal services.

2020-07, Contributed Nonfinancial Assets

- The FinREC believes that the market in which an NFP would normally sell or distribute the asset may not be the principal market
- A not-for-profit may be more interested fulfilling mission than maximizing the amount they would get from selling the assets.
- Therefore, the entity would **not** look to the amount the beneficiaries receiving gifts in kind from not-for-profits would pay since those amounts are not a good indicator of a principal market.
- The market in which the goods would normally be sold is the market that should be considered.

Example

As part of its mission, a not-for-profit agency sells donated food and other products to low-income families at a significant discount. During 20X1 the not-for-profit received donated goods with a fair value of $10,000, which is what a market participant would pay to a low-cost retailer like the Dollar Store. The not-for-profit paid a shipping and handling fee of $1,000. The goods would be sold at an 80% discount in the entity's programs. The accounting manager recorded the contribution revenue at $9,000, a cash disbursement of $1,000 with a corresponding entry to inventory.

2020-07, Contributed Nonfinancial Assets

- Sometimes issues arise when the NFP may have other reasons for not pursuing highest and best use.
- Tax law or donor-imposed restrictions limit the use of the nonfinancial asset to a use other than its highest and best use.
- For example, a donor may provide gifts in kind to a not-for-profit and require that they be restricted to specific geographic locations or sold at auction immediately with the proceeds restricted to a particular program. **This would not alter the fair value but alters the net asset classification.**
- If the limitation was on the asset itself such as a land easement on land then the fair value would be altered because it would alter the perception of the market participant
- Donated pharmaceuticals that are still useful, but the expiration date has occurred or is near to occurring – adjust fair value.

Example

A not-for-profit receives donations of medical supplies from pharmaceutical companies and sends them to developing countries as part of its mission. The standards for expiration are not the same in these countries as they are in the US so many of the products donated are very close or at their expiration date. This makes them less desirable than other products that are sold in the US and a discount should be applied. The CFO valued the products at a discount since the gift differed from others in the market place due to the expiration date.

Test Yourself Question

Which of the following is true of ASU No. 2020-07?

a. All contributed nonfinancial assets will be reported as restricted.

b. The amount of the nonfinancial assets contributed will be reported on a separate line in the statement of activities.

c. Not-for-profits must break down the amount of contributed nonfinancial assets received by category on the face of the statement of activities

d. If the not-for-profit sells the nonfinancial asset during the year it does not need to be reported as nonfinancial.

Test Yourself Question, Solution

Which of the following is true of ASU No. 2020-07?

a. All contributed nonfinancial assets will be reported as restricted.

b. The amount of the nonfinancial assets contributed will be reported on a separate line in the statement of activities.

c. Not-for-profits must break down the amount of contributed nonfinancial assets received by category on the face of the statement of activities

d. If the not-for-profit sells the nonfinancial asset during the year it does not need to be reported as nonfinancial.

Valuation Provided by Donors

- If the not-for-profit receives an appraisal they should challenge it, without bias, to determine whether it is appropriate.
- There are published sources that exist that provide values of various assets that may be received vehicles.
- The FinREC believes that in the entity should consider whether those published sources are appropriate inputs for measuring fair value.
- The value that a donor recognizes for tax purposes may differ significantly from fair value.

Donations Used for Fundraising

- NFP receive items, that are to be used for fundraising purposes
- When the eventual sale happens those gifts in kind can be directly attributed to the original gift from the donor.
- The not-for-profit will report the original contribution as revenue measured at fair value at the date of donation.
- The difference between the amount received for those items from participants at fundraisers and the fair value when originally contributed to is an adjustments to the original contributions.

Contributions of Advertising

- Q&A 6140.24- when nonfinancial assets are used for a NFP's benefit or provided to them free of charge to help the entity with fundraising or communication, the entity should consider whether it has received a contribution.
- The FinREC - in the case of advertising, and media time or space, the NFP should record a contribution if the not-for-profit has an active involvement in determining and managing the message and the use of the materials.
- NFP's involvement in determining and managing the content does need not be absolute in order to conclude that a contribution has been received.

UNIT 2

ASC 842, *Leases*

Significant Differences Between ASC 840 and ASC 842

Differences

- Lessees- Recording operating leases on the balance sheet
- New name for capital leases- finance leases
- Principles based lease classification
- No deferred or prepaid lease expense for operating leases
- More stringent capitalization criteria for initial direct costs
- Enhanced footnote disclosure
- Inception vs. **commencement**

Similarities

- Very few changes for lessors
- Income statement treatment for lessees is unchanged
- Accounting for finance leases is unchanged
- Change in terminology- not significant (ASC 840- reasonably assured vs ASC 842- reasonably certain). Used for adding options to renew leases
- Lease modification and remeasurement accounting

Lease Transition- Overview, Modified Retrospective Approach

Transition Method 1: Adjust comparative periods

- Entities apply ASC 842 to each lease that existed at the beginning of the **earliest comparative period** presented and leases that commenced after that date.
- Prior comparative periods presented are adjusted.
- Cumulative effect adjustment is recognized at that date.

Transition Method 2: Do not adjust comparative periods

- Entities apply ASC 840 to each lease that had commenced as of the **beginning of the current reporting period** with a cumulative effect adjustment as of that date.
- Prior comparative periods are **not adjusted** under this method and are under ASC 840.
- An entity that applies this method must provide the required disclosures under ASC 840 for all periods to which ASC 840 is applied.

Lease Transition- Overview

Transition- Lessee

- If a lease was classified as an operating lease under the guidance in ASC 840 and will continue to be classified as an operating lease under ASC 842, the lessee should recognize a right-of-use asset and lease liability at the application date.
- The application date for companies that choose to adjust comparatives periods is the later of: (1) the beginning of the earliest comparative period presented and (2) the commencement date of the lease.
- The application date for companies that choose to not adjust comparative periods is the effective date.

Lease Transition- Overview

- **Deloitte Review of 50 Fortune 125 Companies- Lease Transition Disclosures**
- 100% used the alternative method and did not restate the prior year
- Of those 50 entities, 18 disclosed a quantitative cumulative catch-up adjustment to retained earnings. 61% of those explained that it was from recognizing previously deferred gains on sale-leaseback transactions. The other entities were silent.

Lease Transition- Possible Elections

Package of practical expedients: These are a package and must be elected together. Entity is required to disclose the practical expedients elected.

1. The entity does not have to determine whether leases are included in existing or expired contracts at the transition date.
2. Entities will not need to reevaluate existing lease classifications.
3. Entities will not need to reevaluate and possibly exclude certain outlays classified as initial direct costs under ASC 840. ☆

   ASC 842 is more restrictive in costs that can be capitalized. It defines initial direct costs as those that could have been avoided had the entity not entered into a lease agreement.

Lease Transition- Other Possible Elections

- **Hindsight** - Entities may elect a practical expedient to use hindsight in determining the lease term and assessing the entity's ROU asset.
- **Land Easements** - Entities can elect not to reassess existing or expired land easements under the definition of a lease under ASC 842.
- **Deloitte Review of Practical Expedients Adopted**
  - 46 out of the 50 companies adopted **all** of the practical expedients (package)
  - 2 out of the 50 took the hindsight practical expedient.
  - 13 out of the 50 elected to take the option related to land easements

Lease Transition- Example

A Company enters into a five-year lease of equipment on January 1, 20X1. The annual lease payments of $45,000 are payable at the end of each year. The lease was originally accounted for as an operating lease. On January 1, 20X2 before transition adjustments, the lessee has **accrued rent on the lease of $25,000** reflecting the amount that has been expensed but not paid. At the time of transition there were 4 years left on the lease. The ROU asset is equal to the lease liability before adjustment for accrued rent. The adjustment removes the accrued rent, adjusting the ROU asset.

Yearly payment	45,000	
Discount rate 6%	3.4651	
PV of 4 payments	155,930	
ROU Asset	155,930	
Lease liability		155,930
Accrued rent	25,000	
ROU asset		25,000
To record the ROU asset, lease liability and to remove the previously accrued rent.		

Lease Refresher- Possible Elections

Practical Expedients- Recognition

- **Use of the Risk-free Rate** - Election only applies to private entities. Use a risk-free rate, for example, a U.S. Treasury obligation, to discount the lease liability and avoid the more complicated calculation of its incremental borrowing rate.
  - Entities should be aware that the lower the discount rate the higher the liability.
  - Entities may now elect by class of asset. (ASU 2021-09)

Lease Refresher- Practical Expedients

Practical Expedients- Recognition

Short Term Lease Exemption - lease with a term of 12 months or less as of the commencement date, without a purchase option, the lessee is reasonably likely to exercise.

- Entities are not required to capitalize and record those leases
- There are disclosure requirements related to this election. This election can be made by class of assets.

Deloitte Review of Fortune 125 Companies

- 41 of the 50 elected the short-term lease recognition exemption
- Only 21 of the 50 entities disclosed short term lease costs. The most common reason is materiality.

Lease Refresher- Practical Expedients

Practical Expedients- Recognition

Separation of Lease and Nonlease Components

- A lessee can elect **not** to separate the consideration into lease and nonlease components.

Deloitte Review of Fortune 125 Companies

- 37 of the 50 elected not to separate the lease and non lease components

Lease Refresher - Considerations

Materiality - The FASB's basis for conclusions (BC421) discuss how IFRS allows for the establishment of a materiality threshold of $5,000 or less for leases that would not be recognized.

- The FASB included no such threshold. FASB observed that, in addition to accounting for some leases at a portfolio level, entities will likely be able to adopt reasonable capitalization thresholds

Related Party Leases - leases between related parties should be classified in accordance with the lease criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease.

- Entities should assess the need for disclosures
- **NEW!** FASB issued ASU 2023-01, an amendment for entities under common control. Expected to be effective for years beginning after 12/15/23.

FASB Targeted Relief for Lessees in Private Companies

NEW! Practical expedient for entities under common control. NFPs that are conduit bond obligors are not eligible.

- 2 narrowly focused practical expedients

1. Entities under common control- if the lease is not documented in writing, then the same "legally enforceable" standard must be met. This could be costly.
   - If leases are in writing the need to determine legal enforceability is not required. Look to terms and conditions in writing.
2. Amortization of leasehold improvements- amortize over useful life. If the lease terminates before that time LHI are derecognized and a equity transfer to the lessor results.

Taxes and Insurance

- Lease payments for taxes and insurance are not a lease component. They may be included in a lease liability and ROU asset.
- Who pays the bill does not matter (reimburse lessor or paying a third party of the lessor's behalf).
- Deciding factor is whether the **payments are fixed or variable**
  - Payments are fixed- should be included in contract consideration as a fixed lease payments. Allocate to the lease and nonlease components.
  - Payments are actual amounts – considered variable lease payments not tied to a rate or index and they are **excluded** from the ROU asset and liability. Expense as incurred.

Discount Rate

- Entities must first consider the rate implicit in the lease. This is the imputed rate.
- If that is not possible then the next step is to consider the entity's incremental borrowing rate.
- The definition of incremental borrowing rate has changed from ASC 840. ASC 842 defines it as the rate of interest that a lessee would have to pay to borrow on a **collateralized basis** over a similar term an amount equal to the lease payments in a similar economic environment. ASC 842 requires a lessee to use a **secured rate**.
- Nonpublic entities can elect to use a risk-free rate to discount the lease liability. It is far easier to derive but may have adverse effects on the liability. The election can be made by asset class.

Definition of a Lease

Definition of a lease:

> ***A contract or part of a contract that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.***

Lease - the contract needs to convey the right to **control** the use of an **identified** asset. Customer must have **both**:

- right to obtain substantially all of the economic benefits from use of identified asset
- right to direct the use of the identified asset

Test Yourself Question

A Lessee wants to make the appropriate decision regarding the lease term. In evaluating whether it is reasonably certain to exercise an option, which would be the least important factor to consider?

a. Contractual terms and conditions for the option periods compared with current market rates.

b. The entity is reluctant to move.

c. Significant leasehold improvements that may not be removed from the premises

d. Costs incurred in terminating the lease, moving, and signing a new one

Test Yourself Question, Solution

A Lessee wants to make the appropriate decision regarding the lease term. In evaluating whether it is reasonably certain to exercise an option, which would be the least important factor to consider?

a. Contractual terms and conditions for the option periods compared with current market rates.

b. The entity is reluctant to move.

c. Significant leasehold improvements that may not be removed from the premises

d. Costs incurred in terminating the lease, moving, and signing a new one

Lease does not have an Explicit End

- Not-for-profit entities may enter into leases with related or unrelated parties that have no explicit end.
- The lessee and lessor should evaluate the enforceable rights and obligations of the contract (an agreement between two or more parties that creates enforceable rights and obligations).
- Any period that may not be cancelled by the lessee should be included in the lease evaluation.
- When assessing the length of the noncancellable period of a lease, an entity should apply the definition of a contract.
- A lease is no longer enforceable when both the lessee and the lessor each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

Lease Refresher- Basics

Fiscal funding clause

- Provides for the cancellation of the lease if the legislature or other funding authority does not appropriate the funds necessary for the government to fulfill its obligations
- Evaluate whether it is more than remote that a lessee will exercise the clause.
- If exercise is more than remote, only the periods for which exercise is remote should be included in the lease term.

Donated Rent

- When rent is 100% donated it is treated as any long-term contribution would be.
- ASU 842 defines a lease as a contract that provides the use of identified property and equipment for a period of time in exchange for consideration. No consideration- no lease.
- Use of space at below market value. Bifurcate into the lease and donation components
- The amount of the contract that represents consideration is considered the lease and is account for under ASC 842. Remainder is a donation.
- When the contract specifies a certain number of periods, record the fair value of the use of the property as a donor restricted (time) contribution and a receivable.
- With each period, the restriction is released, and the net assets are reclassified to the "without donor restriction" category.

Example - Below Market Rent (con't)

Operating Lease

A social service agency (SSA) received the use of space from a business entity. The undiscounted value for the annual rental is $69,000 which is computed at $20,000 Y1, $23,000 Y2 and $26,000 Y3. Consideration paid each year is $5,000 each year so there is a lease component. The remainder is considered an unconditional promise to give which has been assessed as fully collectible. The space is usable in future periods, so the contribution is donor restricted.

Management evaluated the lease and determined it should be classified as an **operating lease**. They do not know the rate implicit in the lease, so SSA used its incremental borrowing rate of 5% to discount.

The first step is to separate the lease component from the contribution. This would be the amount attributable to the lease at fair value.

Example - Below Market Rent (con't)

Operating Lease

Calculating the ROU asset and lease liability	
Value of Lease	
Fair value of rental - 3 X $5,000	15,000
Discount at 5%	(1,380)
Discounted value of rental	13,620
Value of contribution	
Total fair value of arrangement	69,000
Less fair value rents to be paid	(15,000)
Amount attributable to contribution	54,000
Discount on contribution receivable	(5,250)
Discounted value of contribution	48,750

Example - Below Market Rent (con't)

The next chart illustrates the rent (lease) expense. In an operating lease under ASC 842 the lease is a consistent amount. Although it represents the same components of interest and amortization of the ROU asset, the distinction is that the ROU asset is adjusted so that the lease expense is ratable over the years. In the finance lease, the ROU asset is amortized at a consistent rate and the lease expense is not consistent.

Operating Lease	Year 1	Year 2	Year 3
Lease liability, beginning	13,620	9,290	4,750
Amortization treated as lease expense (Interest in finance lease)	670	460	250
Minus lease payment	(5,000)	(5,000)	(5,000)
	9,290	4,750	-
Right of Use Asset			
ROU asset, beginning	13,620	9,290	4,750
Less amortization - lease expense (Amortization in finance lease)	(4,330)	(4,540)	(4,750)
	9,290	4,750	-
Lease expense is one consistent amount	5,000	5,000	5,000

$4,330
$4,540
$4,570

For operating lease

Example - Below Market Rent (con't)

Operating Lease

Analysis of contribution receivable

Contribution Receivable	Year 1	Year 2	Year 3
Contribution rec. beginning of year	$ 54,000	$ 36,190	$ 20,000
Beginning of year discount	(5,250)	NA	NA
Amortization of discount (5%)	2,440	1,810	1,000
Fair value of donated lease rental	(15,000)	(18,000)	(21,000)
Contribution rec. end of year	$ 36,190	$ 20,000	$ -

Journal entries- operating lease		
ROU Asset (net of discount)	13,620	
Lease liability		13,620
Entry to record contribution		
Contribution receivable	48,750	
Contribution revenue - donor restricted		48,750

Example - Below Market Rent (con't)

Operating Lease

Journal entries for operating lease - 3 years	Year 1		Year 2		Year 3	
Portion that represents the lease						
Lease expense	5,000		5,000		5,000	
Lease liability	4,330		4,540		4,750	
Cash		5,000		5,000		5,000
ROU asset		4,330		4,540		4,750
Portion that represents the contribution						
Lease expense	15,000		18,000		21,000	
Contribution receivable		15,000		18,000		21,000
Net assets released from restriction (donor restrictions)	15,000		18,000		21,000	
Net assets released from restriction (w/o donor restrictions)		15,000		18,000		21,000
Contribution receivable	2,440		1,810		1,000	
Amortization of discount (cont. revenue with donor restrictions		2,440		1,810		1,000

$5,000 X 3 =$15,000

With a finance lease the expense would be divided into amortization and interest expense.

$15,000+$18,000+ $21,000= $54,000

Disclosures - Qualitative Information, Lessee

- Policy elections (transition and other)
- Information about the nature of leases and subleases including:
  - General description
  - Basis on which variable lease payments are determined
  - Existence and terms and conditions of options to extend or terminate the lease. The narrative should discuss those that are included in ROU assets and liabilities as well as those that are not.
  - Existence and terms and conditions of residual value guarantees
  - Restrictions or covenants imposed by leases
  - Information about leases that have not commenced but that create significant rights and obligations

Disclosures - Qualitative Information, Lessee

- Information about **significant assumptions and judgments** made in applying the standard which includes:
  - Whether the contract contains a lease
  - Allocation of consideration in a contract between leases and nonlease components
  - Determination of the discount rate
  - Main terms and conditions of any sale and leaseback transactions
  - Whether an accounting policy was made for short term lease exemption.
  - If the short-term lease expense does not reflect the lessee's short term lease commitments a lessee should disclose that fact and the amount of the short-term commitments

Disclosures - Significant Judgments and Estimates

Example Footnote 1:

The present value of the lease payments is calculated using the incremental borrowing rate for operating and finance leases, which was determined using a portfolio approach based on the rate of interest that the Organization would have to pay to borrow an amount equal to the lease payments on a collateralized basis over a similar term. The Agency uses an unsecured borrowing rate and risk-adjusts that rate to approximate a collateralized rate which will be updated on a quarterly basis for measurement of new lease liabilities.

Example Footnote 2:

For most leases, the implicit rate is not readily determinable. Accordingly, the Agency uses a discount rate in determining the present value of future payments based on the yield-to-maturity of our secured publicly traded debt instruments interpolating the duration of the debt to the term of the executed lease.

Disclosures - Significant Judgments and Estimates

Example Footnote 3:

The lease liabilities are measured at the lease commencement date and determined using the present value of the minimum lease payments not yet paid and the Organization's incremental borrowing rate, which approximates the rate at which the Organization could borrow, on a secured basis. The interest rate implicit in the lease is generally not determinable in transactions where the Organization is the lessee.

Example Footnote 4:

The Organization generally uses its fully collateralized incremental borrowing rate as of the commencement date to calculate and record the lease. The incremental borrowing rate is influenced by factors such as credit rating and lease term and therefore, may differ for individual leases, embedded leases or portfolios of leased assets.

Disclosures - Quantitative Information, Lessee

- Finance lease cost, segregated between the amortization of the right-of-use assets and interest on the lease liabilities.
- Operating lease cost
- Variable lease
- Sublease income, disclosed on a gross basis, separate from the finance or operating lease expense.
- Net gain or loss recognized from sale and leaseback transactions
- Amounts segregated between those for finance and operating leases for the following items:
  - Cash paid for amounts included in the measurement of lease liabilities, segregated between operating and financing cash flows
  - Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets

Disclosures - Quantitative Information, Lessee

- Maturity analysis of its finance lease and operating lease liabilities, separately showing:
  - Undiscounted cash flows on an annual basis for a minimum of each of the next five years and thereafter
  - Reconciliation of the undiscounted cash flows to the discounted finance lease liabilities and operating lease liabilities recognized in the statement of financial position
- Short-term lease cost, excluding expenses relating to leases with a lease term of one month or less
  - If the lessee elected the short-term lease exemption this should be disclosed and disclose amount of commitments
- Weighted average lease term information and weighted average discount rate information

Accounting Policy- Lessee

Leases

The Agency determines if an arrangement is a lease at **inception**. Operating leases are **included** in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in the consolidated balance sheets. Finance leases are **included** in property and equipment, other current liabilities, and other long-term liabilities in the consolidated balance sheets. ROU assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are **recognized** at **commencement date** based on the present value of lease payments over the lease term. As most of the leases do not provide an implicit rate, **the Agency generally uses an incremental borrowing rate** based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date.

Accounting Policy- Lessee

Leases (con't)

The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Agency will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Agency has lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, the Agency accounts for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, the Agency applies a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Disclosures Related to Income Statement- Lessee

Note 14 Leases

The Organization has operating and finance leases for datacenters, corporate offices, research and development facilities, and certain equipment. Our leases have remaining lease terms of 1 year to 19 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows (millions):

Year ended June 30,	2022	2021	2020
Operating Lease Cost	2,461	2,127	2,043
Finance Lease Cost			
Amortization of right-of-use assets	980	921	611
Interest on lease liabilities	429	386	336

Financial Statement Presentation- Lessee

Balance Sheet

- ROU asset separate from other assets and finance leases separated from operating leases
- Lease liabilities separate from other liabilities and finance leases separated from operating leases
- Alternatively, present the ROU assets with assets which are owned and disclose information in the notes about where the information is located on the balance sheet

Financial Statement Presentation- Lessee

Statements of Financial Position (In millions)		
June 30,		
	2022	2021
Assets		
Current assets:		
Cash and cash equivalents	$ 104,757	$ 130,334
Accounts receivable, net of allowance for doubtful accounts of $633 and $751	44,261	38,043
Inventories	3,742	2,636
Other current assets	16,924	13,393
Total current assets	169,684	184,406
Property and equipment, net of accumulated depreciation of $59,660 and $51,351	74,398	59,715
Operating lease right-of-use assets	13,148	11,088
Equity investments	6,891	5,984
Goodwill	67,524	49,711
Intangible assets, net	11,298	7,800
Other long-term assets	21,897	15,075
Total assets	$ 364,840	$ 333,779

	2022	2021
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 19,000	$ 15,163
Accrued compensation	10,661	10,057
Short-term unearned revenue	15,278	12,639
Other current liabilities	13,067	11,666
Total current liabilities	95,082	88,657
Long-term debt	30,851	41,364
Long-term unearned revenue	2,870	2,616
Operating lease liabilities	11,489	9,629
Total liabilities	198,298	191,791
Commitments and contingencies		
Net Assets		
Without donor restriction	82,261	83,111
With donor restriction	84,281	58,877
Total Net Assets	166,542	141,988
Total Liabilities and Net Assets	$ 364,840	$ 333,779

Disclosures- Balance Sheet, Lessee

Supplemental balance sheet information related to leases was as follows (In millions, except lease term and discount		
June 30,	**2022**	**2021**
Operating Leases		
Operating lease right-of-use assets	**$ 13,148**	$ 11,088
Other current liabilities	**$ 2,228**	$ 1,962
Operating lease liabilities	**11,489**	9,629
Total operating lease liabilities	**$ 13,717**	$ 11,591
Finance Leases		
Property and equipment, at cost	**$ 17,388**	$ 14,107
Accumulated depreciation	(3,285)	(2,306)
Property and equipment, net	**$ 14,103**	$ 11,801
Other current liabilities	**$ 1,060**	$ 791
Other long-term liabilities	**13,842**	11,750
Total finance lease liabilities	**$ 14,902**	$ 12,541

Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**12 years**	12 years
Weighted Average Discount Rate		
Operating leases	**2.1%**	2.2%
Finance leases	**3.1%**	3.4%

Disclosures- Balance Sheet, Lessee

The following table outlines maturities of our lease liabilities as of June 30, 2022				
(In millions)				
Year Ending June 30,		**Operating Leases**		**Finance Leases**
2023	$	2,456	$	1,477
2024		2,278		1,487
2025		1,985		1,801
2026		1,625		1,483
2027		1,328		1,489
Thereafter		5,332		9,931
Total lease payments		15,004		17,668
Less imputed interest		(1,287)		(2,766)
Total	$	13,717	$	14,902

As of June 30, 2022, the Center has additional operating and finance leases, primarily for datacenters, that have not yet commenced of $7.2 billion and $8.8 billion, respectively. These operating and finance leases will commence between fiscal year 2023 and fiscal year 2028 with lease terms of 1 year to 18 years.

Financial Statement Presentation- Lessee

- **Statement of Cash Flows**
  - Cash payment for the principal portion of the lease liability arising from finance leases- in financing activities
  - Cash payment for the interest portion of the lease liability arising from operating leases- in operating activities
  - Cash payment arising from operating leases- in operating activities
  - Variable lease payments and short-term lease payments not included in the lease liability within operating activities

Cash Flow Disclosure -Lessee

Supplemental cash flow information related to leases was as follows (in millions):

Year ended June 30,	2022	2021
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	2,368	2,052
Operating cash flows from finance leases	429	386
Financing cash flows from finance leases	896	648
Right of Use assets obtained in exchange for lease obligations		
Operating leases	5,268	4,380
Finance leases	4,234	3,290

Unit 3

ASU 2016-13 Current Expected Credit Losses

KAPLAN

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- ASU 2016-13, Financial Instruments - Measurement of Credit Losses on Financial Instruments (ASC 326)
- Large SEC filers have already implemented the standard. Smaller reporting companies, private companies and all others – effective date- fiscal years beginning after Dec. 15, 2022
- Impairment standard- Underlying premise of the standard is that financial assets have credit risk throughout the holding period and that risk is present on Day 1.
- Generally viewed as applying to financial institution, almost every organization will be impacted in some way.
- This presentation discusses NFP applications of the standard.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- Objectives:
    - Reduce complexity in GAAP by reducing most credit impairment models that entities use to account for debt instruments
    - Eliminate the barrier to timely recognition of credit losses by using the expected loss model instead of the incurred loss model
    - Require an entity to recognize an allowance of lifetime expected credit losses
    - Permit flexibility in how entities calculate expected credit losses
    - Removes the “probable” threshold and require recognition of “expected” losses- lifetime losses are reported on Day 1
- Several recently issued standards conform as much as possible to IFRS. CECL has distinct differences.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- CECL is not just for financial institutions although they are more heavily impacted:
  - Financing receivables (loans and other financing receivables)
  - Programmatic investments (loans)
  - Held-to-maturity debt
  - Trade receivables (receivables from revenue transactions)
  - Contract assets resulting from revenue transactions
  - Receivables on repurchase and securities lending agreements
  - Net investments in leases recognized by lessors and lease receivables
  - Loan commitments, guarantees, standby letters of credit (off balance sheet)
  - Reinsurance recoverables

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- CECL does not apply to:
  - financial assets at fair value
  - available-for-sale debt (although there is an updated model ASC 326-30 with similar concepts)
  - participant loans made by defined contribution benefit plans
  - insurance policy loans
  - NFP pledges receivables
  - Receivables arising from operating leases.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

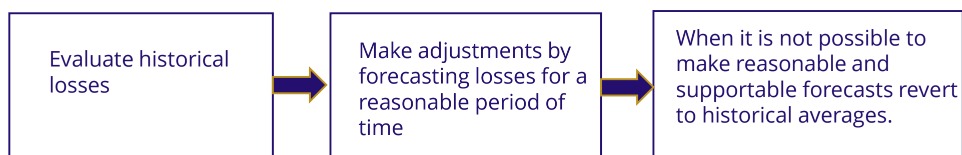
Summary

	Existing Guidance	CECL
Recognition	When probable a loss has been incurred	When losses are expected (in almost all cases upon the initial recognition of the asset)
Period	No explicit input to model	Contractual term
Consideration points	Historical loss and current economic conditions	Historical loss, current economic conditions, **reasonable and supportable** forecasts about future conditions . Reversion to historical loss information for future periods beyond those that can be **reasonably forecasted**.
Unit of account	Pooling permitted but not required	Pooling **required** when assets share similar risk characteristics. When characteristics are not susceptible to pooling, evaluate individually.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

Summary of Credit Loss Estimation Process

Objective: at inception and at each reporting date, recognize an allowance for expected **lifetime** credit losses (cash flows not expected to be collected over time). Immediately recognize credit losses into income.



ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- Organization should base the estimates on:
  - Available and relevant internal and/or external information (historical loss experience)
  - Current and anticipated future conditions
  - Reasonable and supportable forecasts that affect the expected collectability of the reported financial assets
- There may be periods beyond which the organization can make supportable forecasts
  - Revert to historical information base on the contract term of the asset
  - This is part of the process, not a policy election

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

Reasonable and supportable forecasts

At implementation, the measurement period for the NFP's pooled loan portfolio was 5 years. Management obtained 8 years of historical information from the financial system and employment statistics. Based on their analysis unemployment stats correlated with loss experience. Indicating that the cumulative loss experience was a good estimate of loss. Historical information was the starting point. In the current year, the cumulative loss experience was 4.5%.

Management did not believe it would be possible to have a reasonable and supportable forecast out more than 2 years since inflation was rising. This had just begun toward the end of the current year.

Management made their projections using cumulative loss experience of 5.5% for those years. For the next 3 years they reverted back to historical experience because the forecasts were no longer reasonable and supportable. For the remaining 3 years, 4.5% was used.

	Year	Rate of Unemployment	Cumulative loss experience
8 prior years	Year 8	5.50%	4%
	Year 7	5.25%	3.75%
	Year 6	4.00%	3.50%
	Year 5	3.75%	3.50%
	Year 4	3.75%	3.25%
	Year 3	4.50%	4%
	Year 2	5.50%	4%
	Year 1	5.75%	4%
Current year →	Year 0	6.00%	4.50%

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- Organization will estimate credit losses over the entire contractual term of the instrument
- Contract term includes all extensions or renewal options (except derivatives) that are not unconditionally cancellable by the entity
- Credit losses that share similar risk characteristics (effective interest rate, geographic location, size, type, risk rating) **must** be considered together (**pooled**).
- Risk characteristics include credit and noncredit factors

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

Risk characteristics for evaluating pools:

- Internal or external (third-party) credit score or credit ratings
- Risk ratings or classification
- Financial asset type
- Collateral type
- Size
- Effective interest rate
- Term
- Geographical location
- Industry of the borrower
- Vintage
- Historical or expected credit loss patterns
- Reasonable and supportable forecast periods.

If the asset's risk characteristics change and no longer correspond to the pool, if there is no other pool for it to fit in, it is evaluated individually

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- Initial measurement and any changes are recognized as credit loss expense (or reversal) in the **current period income statement**
- Assets are presented at the net amount to be collected
- Allowance for loan and lease losses is the offset or in the case of off-balance sheet exposure as a liability
- **Estimated recoveries** - include in credit loss determination either
  - Accounting for recoveries by increasing the allowance for expected credit losses
  - increasing earnings directly.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- **Write offs** - asset is written off when entity concludes that a portion or all of the receivable is not collectible. This is a balance sheet impact.
- Factors to consider:
  - organization has enough information to determine customer insolvency
  - organization receives notice that customer filed for bankruptcy and collectability is impacted
  - amount has been past due for a period of time with no response from the customer
  - organization receives word from the customer that they do not intend to pay

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- There is no one prescribed methodology for estimating credit losses
- Acceptable methods identified by the FASB are:
  - **Discounted cash flow** - projects future principal and interest cash flows and discounts them at the financial asset's effective interest rate. Allowance is difference between carrying value and fair value.
  - **Loss-rate methods** - measures loan losses over the life of a loan pool and compares losses to the outstanding remaining pool balance. This is considered to be the easiest method. FASB issued a Staff Q&A on this model.

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- Acceptable methods (con't)
  - **Vintage method** - Closed portfolio (loans). Considers historical losses by origination year and age. Allowance is interpolated.
  - **Aging method** - It is commonly used for estimating allowances on trade receivables.
  - **Roll rate method** - Using historical trends in credit quality indicators such as delinquency and risk ratings
  - **Probability of default** - determined by multiplying the probability of default by the loss given default (percentage of asset not expected to be collected because of default)

ASU 2016-13, *Measurement of Credit Losses on Financial Instruments* (CECL)

- **Investments in debt instruments**
- Foundations and other NFPs with endowments frequently invest in debt securities.
- ASC 958-320 requires a NFP to mark investments in debt securities to fair value.
- Therefore, CECL is not applicable here.

Guarantees

- Community Foundations often offer guarantees as a part of their community programs.
- Other organizations may guarantee the debt of an affiliate or some other party.
- A guarantee in the scope of Subtopic 326-20 consists of two components, one of which is recognized and measured under Topic 460, Guarantees, and the other under Subtopic 326-20, Credit Losses.

Non-contingent obligation to stand ready to perform

Contingent obligation to make future payments if specific conditions occur

Guarantees

- **Non-contingent** stand-ready obligation- liability is recognized under ASC 460 at fair value at inception.
  - The fair value of a guarantee inherently includes a market participant's assumptions regarding credit risk in the guarantee.
  - FinREC recommends using the interest differential as the amount of the non-contingent portion of the guarantee for a NFP.
- **Contingent obligation** - a separate liability for off-balance sheet credit risk is recognized under ASC 326-20 for expected credit losses related to the contingent obligation.
- The FASB decided that this approach was necessary to appropriately present expected credit losses on guarantees without affecting the accounting for the non-contingent obligation.

Guarantees

- Two aspects of the guarantor's estimation of expected credit losses for the **contingent** obligation:
  - the likelihood that the guarantor will have to fulfill the obligation
  - an estimate of expected credit losses on the obligation.
- The estimate of expected credit losses on the obligation considers the risk attributes of the guarantee.
- ASC 460 does not prescribe accounting guidance for the **non-contingent** aspect of guarantees subsequent to initial recognition.
- Instead, it describes that the liability is generally reduced through net income as the guarantor is released from risk under the guarantee.
- The FinREC states that the offset is a statement of activities account such as reduction of grant expense or revenue.

Guarantees

- Measurement of the guarantee liability for the **contingent aspect** of the guarantee is determined under ASC 326-20. At each reporting date, an organization estimates expected credit losses and adjusts the liability for off-balance sheet credit losses through net income.
- This is expected to result in larger liability because previously the incurred model was used for the contingent liability.

Programmatic Investments

- **Relevant Literature**: ASC 326 and ASC 835
- As part of their programs a NFP may make investments in other NFPs or constituents.
  - ☆ Low interest or interest free loans to students with demonstrated need
  - ☆ Student loans that are forgiven after graduation when a specified amount of community service is provided
  - Investments in nonprofit, low-income housing projects
  - ☆ Loans to small for-profit business that are owned by members of an economically disadvantaged group where loans are not available commercially
  - Investments in blighted urban areas to provide jobs or job training to residents
  - ☆ Guarantees of a NFP's debt

☆ Programmatic investments where CECL applies.

Programmatic Loans

Diversity in Practice

- Programmatic loans are challenging because they are made to entities that have more credit risk than most those who receive commercial loans are.
- Depending on the intent of the NFP in making the programmatic investment they may be loans where the NFP identifies the credit risk and imputes a rate of interest that incorporates the amount the NFP does not expect to collect.
- Referred to as the effective interest rate approach.
- Others are treated as contributions made to others.

Programmatic Loans

Effective Interest Rate Approach

- Loans may bear a market rate of interest or below-market interest or interest free.
- With below market rate loans, the NFP knows that the borrower would not be able to afford the loan otherwise and this is part of the organization's loan program.
- ASC 835 provides guidance on imputing interest on receivables regardless of whether they are interest free or bear interest at a below-market rate.
- Since the loans held by NFPs are not traded on the market the way commercial loans it is difficult to determine the present value.
- In the case of a programmatic loan the difference between the cash transferred to the borrower and the present value of the contractual payments at the effective interest rate is considered a contribution expense.

Programmatic Loans

Scenario 1: A Community Foundation made a 5-year loan to an organization that assists the unemployed in finding work. The loan is a no interest loan with payments of $5,000 per year and a balloon payment at the end of the 5-year period.

The Community Foundation believes the NFP has significant credit risk. The five-year $100,000 loan is discounted at 15% which is deemed to be a market rate. To do this the Community Foundation considered that the loan was unsecured, the credit worthiness of the NFP, time value of money and market rates.

The Community Foundation regards this as a part of its mission so the discount on the loan is recorded as contribution (program) expense.

	Debit	Credit
Loan receivable	$100,000	
Contribution expense	45,949	
Cash		$100,000
Discount on loan receivable		45,949

Programmatic Loans- Example

Valuation Allowance- Current Expected Credit Loss

The accounting for valuation allowances effective for years beginning after December 15, 2022. The Community Foundation is required to implement the new current expected credit loss standard (CECL) which is a change from the incurred loss model in effect before the effective date. Loans are evaluated for the expected losses. Since the Community Foundation makes this sort of loan as one of its programs it will aggregate this loan with others with similar risk, duration, and other characteristics. There is no one specific model to use to evaluate the loan receivable. The easiest model to use is the discounted cash flow model. In this model the Community Foundation would use the carrying value of the loan which at inception is the loan receivable minus the discount ($100,000- $45,949= $54,051).

Programmatic Loans- Example (con't)

Note Receivable for Community Foundation 15% interest							
Year	Contractual Cash Flow	Discount at 15%	Present value of loan receivable	Expected cash flow	Discount at 15%	Present value Expected	Difference
20X1	5,000	0.8696	4,348	5,000	0.8696	4,348	
20X2	5,000	0.7561	3,781	5,000	0.7561	3,781	
20X3	5,000	0.6575	3,288	5,000	0.6575	3,288	
20X4	5,000	0.5718	2,859	5,000	0.5718	2,859	
20X5	80,000	0.4972	39,776	15,000	0.4972	7,458	32,318
Total cash flow	100,000		54,051	35,000		21,733	32,318
PV cash flow							

The valuation allowance at inception is $32,318.

	Debit	Credit
Impairment loss	$32,318	
Allowance for loan losses		$32,318

Write-offs of loans will be against the valuation allowance.

Programmatic Loans

- **NFP Expects to collect all required payments**
- A NFP may also make loans where they expect that the borrower will pay all the required payments.
- The programmatic piece is the below market rate that is given to them.
- The discount would be the imputed interest which is the differential between the stated rate and the market rate.
- This would be recorded as contribution expense.
- CECL would still be applied, and the cash flows expected evaluated in the same manner.

Net Investment in Lease

- Relates to lessors- sales type or direct financing leases
- Net investment = Lease receivable (including guaranteed residual), unguaranteed residual, deferred selling profit are discounted at the rate implicit in the lease
- The evaluation of the:
  - Risk considerations- risk of lost rental payments, benefits of guarantees on the residual assets and risk of loss on unguaranteed residual assets. Risk of loss due to change in value of the unguaranteed residual asset (not related to default)
  - Contractual term includes options to extend
  - Non-lease components are also evaluated if the organization recognizes a receivable for them

Credit Loss on Net Investment in Lease- Example

A NFP enters into a lease classified as a sales type lease. The lease is for 5 years with annual payments of $10,000. The lessor uses the rate implicit in the lease. There is no residual value guarantee. The lessor's historical information indicates that the loss on sales type leases is 4% and management believes that this rate will increase to 6% due to economic factors over the term of the lease. If there is no default the loss on the residual asset has been evaluated as a 92% likelihood of a 5% loss.

5 year lease	5
Annual payments	10,000
Unguaranteed residual	7,000
Net investment in lease	46,160
Sales type lease	
Historical loss experience	4%
Loss experience is expected to increase over the 5 years	2%
Amount of loss on default	10%
Expected loss rate on residual value	5%
Risk of default	
	46,160
Expectation that historical loss will rise to	6%
Amount of loss expected on default	10%
	277
Risk of loss on residual value of asset	
(if default does not occur)	7,000
Percentage likely to occur	92%
Expected loss rate on residual asset	5%
	322
Total estimated credit loss	**599**

Accounts Receivable

- One of the most likely uses of the CECL method will be for accounts receivable.
- The incurred loss model has often been misused where organizations will apply the direct write-off method which is not GAAP.
- Those that use the allowance method may use a specific percentage of sales or will only place an allowance on specifically delinquent receivables.
- The CECL method stresses that even at inception a certain percentage of receivables will be uncollectible.
- The method that is most frequently used to estimate credit losses is the aging method.
- This is very similar to the model used by many organizations today except that it must incorporate reasonable and supportable forecasts of future conditions.

Illustration of Aging Analysis

One of the major programs of Helping Hands is to provide employment for people with learning disabilities. Helping Hands assembles and packages and sells cleaning products to several different customer types with the majority of sales going to retail stores. Management believes that historical loss information is a reasonable basis to determine expected credit losses because the composition of the receivables is consistent with what was used to develop the historical loss percentages. Customers and lending practices have not changed significantly over time. However, due to general inflationary pressures in the market, customers are not buying from the retailers they serve. Management expects there will be additional reluctance to spend on the part of consumers which will cause retailers to order less product over the next 15 months. Therefore, management adjusted the historical loss rates to reflect the differences in current conditions and forecasted changes.

The spreadsheet illustrates the comparison of the allowance for credit losses using the incurred loss method and the CECL vintage (aging) method.

Illustration of Aging Analysis (con't)

000s omitted					
Aging (Past Due)	**Amortized cost basis**	**Existing loss rate**	**Existing allowance**	**New adjusted loss rate**	**Allowance Under CECL**
Current	$ 9,425	0.0%	$ -	1.8%	$ 165
1-30 days	$ 5,346	8.0%	$ 428	8.5%	$ 454
31-60 days	$ 2,598	32.0%	$ 831	33.0%	$ 857
61-90 days	$ 1,377	52.0%	$ 716	55.0%	$ 757
>90 days	$ 759	93.0%	$ 706	95.5%	$ 725
Allowance			$ 2,681		$ 2,959
Adjustment					$ (278)
	Credit expense		278		
	Allowance for credit losses			278	
To convert existing allowance from the incurred loss method to the CECL aging method.					

Can An Expected Credit Loss be $0?

Possibly but **documentation** will be very important here. The organization could consider:

- U.S. Treasuries (in a NFP this is not likely because investments are marked to fair value.)
- Explicitly guaranteed by a sovereign entity that can print its own currency.
- Receivables from U.S. and other foreign governments
- Consistent high-credit rating by rating agencies
- Long history with **no** credit losses
- Collateral that is required to be evaluated and brought to loan value

Transition Guidance

- **Modified retrospective method** - record the cumulative effect of change on net assets as of the beginning of the first period the guidance is effective.
- Report nature of change in accounting principle and method of applying change.
- Most public companies have found this is not material, but in a NFP materiality will be smaller.
- If it is then disclose the effect of adoption on balance sheet line items as of the beginning of the first period guidance is effective.
- If the organization elected the fair value option (ASU 2019-05) disclose this as well as the difference between the carrying amount and fair value that was recorded as a cumulative effect adjustment to beginning net assets.

Example CECL Transition Disclosure

Adoption of Accounting Pronouncement

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” which introduced an expected credit loss model for the impairment of financial assets measured at amortized cost. The model replaces the probable, incurred loss model for those assets and broadens the information an organization must consider in developing its expected credit loss estimate for assets measured at amortized cost. On January 1, 2023, we adopted ASU No. 2016-13 with no material impact to our consolidated financial condition, results of operations or cash flows.

Disclosure Requirements

- Summary of significant accounting policies
- Credit quality information
- Allowance for credit losses
- Past due status
- Nonaccrual status
- PCD assets
- Collateral-dependent financial assets
- Off balance sheet credit exposures

A Few Post Adoption Complexities

- There are several models for determining expected credit losses.
- Nonbanks tend to use the aging method which is a legacy model used for receivables.
  - Aging may not reflect the current expected credit risk in a downturn or recovery market
  - Downturn or recovery in a market may affect different entities at different times. Watch CECL pools. Geography and other pooling characteristics may make a difference.
  - Concessions vs credit losses. Evaluate data for how much of non-collection is due to concessions vs credit losses in a downturn or recovery situation.

Recently Issued Literature Affecting CECL

- Not expected to impact many NFPs
- **ASU 2022-02** - eliminates the accounting guidance for TDRs by creditors in ASC 310-40 and enhances disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty.
- **ASU 2019-11** - Affects allowance on PCD assets, transition relief for TDRs, disclosure relief for accrued interest receivables extended, financial assets secured by collateral maintenance provisions
- **ASU 2019-05** - Provided entities with the option to elect fair value option on adopting ASC 326. (not applicable to HTM debt securities)
- **ASU 2019-04** - entity may make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets and on AFS debt securities. Made other corrections and confirms certain information.

Unit 4

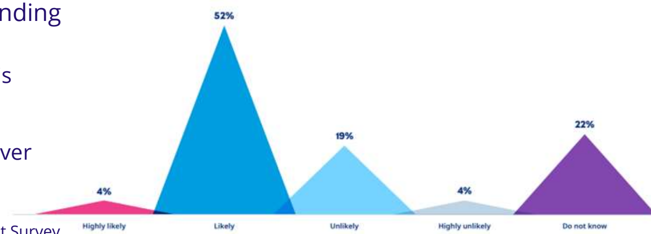
Focus on Endowments

KAPLAN

Endowment Funds- 2023

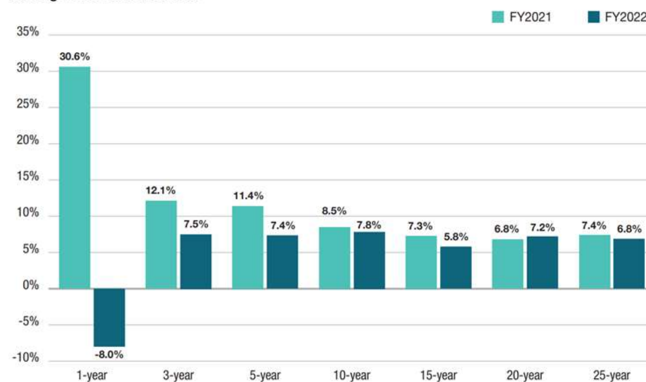
- NFPs have faced a combination of interconnected challenges, that in some way affect their endowment strategies and endowment investments
  - Geo-political conflicts affecting global investments
  - High inflation- in 2022 half of the respondents to Mercer's survey of foundation and endowment managers responded that inflation was one of their two main investment concerns
  - Market volatility
  - Demand for services and the changing fundraising environment has put pressure on endowment spending

More than half of the respondents believe that it is at least likely that their portfolios will meet stated financial return objectives over the next 3 years.



Source: Mercer 2022 Global Not-for-profit investment Survey

Endowment Funds- 2023



2022 was not kind to endowments. After experiencing a high annualized return in 2021, endowments faced a significant decline.

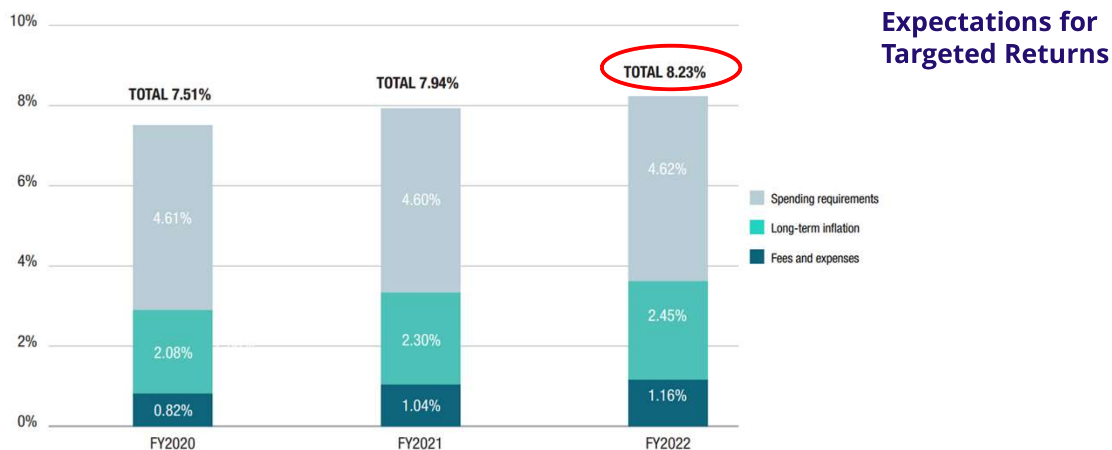
Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Funds- 2023

- Interestingly enough, where there was a -8% return on portfolios, the overall 4% decrease in endowment size would have been worse had it not been for a surge in giving.
- Endowment gifts generally are made in November and December. The market downturn did not begin until January 2022. NFPs saw a 22% increase in giving during fiscal year 2022 (7/1/21-6/30/22).
- For years the target return for endowments has been 7.5%. In FY 2022 the implicit hurdle rate rose to 8.23% because of inflation expectations and projected fees and expenses.
- This may be difficult to achieve given expectations of investors that investment returns will be modest for the next few years.

Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Funds- 2023

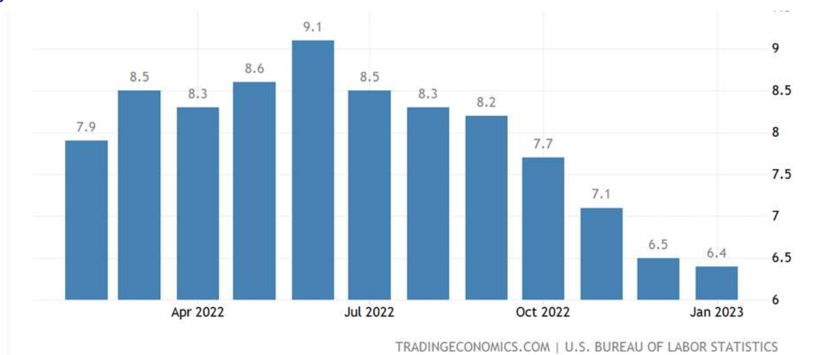


Expectations for Targeted Returns

Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Funds- 2023

- Inflation has been historically low for the 10 years leading up to 2020 (0% to 3%)
- By June 2022 inflation rose to a high of 9.1%. The remainder of 2022 and the beginning of 2023 saw reductions.

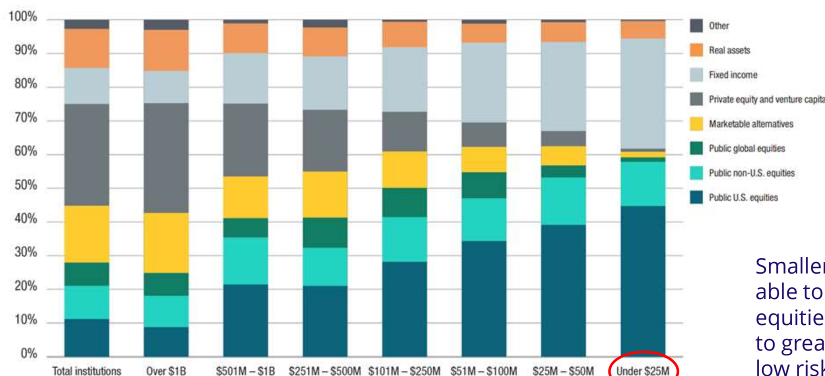


Endowment Funds- 2023

- Rise in inflation causes the central bank interest rates and bond yield to rise. This means that debt service costs are higher for borrowers.
- As bond yields rise bond prices decrease.
- Public equities and commodities have declined as well causing endowments and foundations (E&F) considerable issues.
- Returns are not meeting and in many cases are exceeding the endowment spending policies and expenses so that maintaining purchasing power of the portfolio is challenged in the short term.
- Diversification is important for institutional investors.
- Mercer's Global Inflation Survey (2022) showed that 61% of respondents plan to add to private equity holdings and 53% are targeting real estate assets which are viewed to be a protection against inflation.

Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Funds- 2023



Smaller endowments are not as able to diversify into private equities and venture capital due to greater fee sensitivity and low risk tolerance as well as different liquidity requirements.

Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Funds- 2023

- The large returns in FY2021 compared to the far lower returns in FY2022 led average effective spending rates to decrease in FY2022 even though withdrawal levels increased.

	2021	2022
Average effective annual spending rate	4.79%	4.17%

- Spending policy distributions in higher ed institutions for FY 22 were spent mostly on student financial aid (46%), endowed faculty positions (11%), operations and maintenance (10%), academic programs and research (16%), other purposes (17%).

Source: https://www.nacubo.org/Research/2022/NACUBO-TIAA-Study-of-Endowments

Endowment Strategic Challenges

1. Adapting to higher inflation rates
2. Balancing investment returns and philanthropic goals- ESG
   - Poor returns in 2022 have prompted investment committee to challenge whether the ESG investments are producing the best outcomes
   - Political and special interest backlashes a growing. Example- Texas and Florida have moved to ban asset managers from doing business with state entities if they screen out oil and gas investments.
   - "Greenwashing"- some managers are marketing their investment strategies as more green than they actually are.
   - 67% of respondents said they adopted ESG beliefs to align their mission with the portfolios.
   - Over half the respondents noted an intention to support and benefit from emerging clean energy investment opportunities. Climate change is one of the biggest investment opportunities identified in the survey along with diversifying away from traditional asset classes
   - 72% expressed an intent to increase ESG related investments in the next 12 months

ESG Investing and NFPs

- ESG investing refers to responsible investing that incorporates environmental, social, and governance factors into the investment process and decision-making

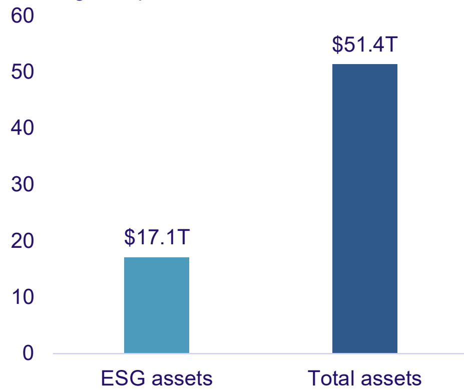
- **Environmental criteria** consider how a company safeguards the environment, including corporate policies addressing climate change, for example.
- **Social criteria** examine how it manages relationships with employees, suppliers, customers, and the communities where it operates.
- **Governance** deals with a company's leadership, executive pay, audits, internal controls and shareholder rights.

- NFPs started out viewing ESG as a tool to enhance the organization's reputation.
- Now it is viewed as a way to meet/enhance financial performance
- Some NFPs have been hesitant to embrace the concept
- ESG matters a lot to certain donors
- Many believe it's not just the NFPs but how they carry it out

Source: Forbes, Morgan Stanley Capital International, US SIF, Politico.

ESG Investing

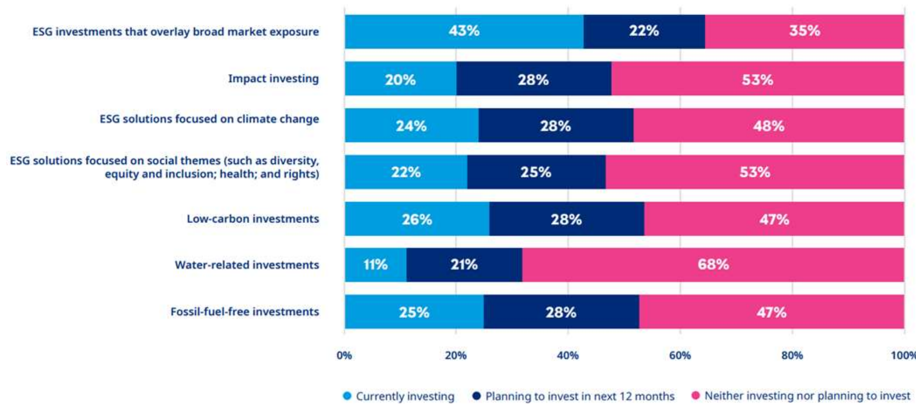
$17.1 trillion of professionally managed assets at the start of 2020 were under strategies that considered ESG criteria in their investment process and decision-making, compared to **$8.1 trillion** in 2016 and **$2.5 trillion** in 2010



Source: Forbes, Morgan Stanley Capital International, US SIF, Politico.

ESG Investing and NFPs

Is your organization currently investing in any of the below, or planning to invest, in the next 12 months?



Source: Mercer. "Making Waves: A Spotlight on Water Scarcity," *Critical Thinking, Critical Issues*, 2022, available on Apple Podcasts at https://podcasts.apple.com/ie/podcast/making-waves-a-spotlight-on-water-scarcity/id1555223857?i=1000558162219.

Unit 5

Single Audit Update

Proposed Changes to Yellow Book

- GAO issued ED of proposed changes to *Government Auditing Standards* (Yellow Book) February 2023
- Intent to issue final in 2023 (GAO is calling this the 2023 YBK)
- Narrow in scope covering Chapter 5, *Quality Control and Peer Review*, to strengthen an audit organization's framework for conducting high-quality government audits through its quality management system. Really more for government audit organizations since it allows for system implemented as required by SQMS 1 and 2.
- ED also proposes a change to Chapter 6, *Standards for Financial Audits*, to add application guidance to provide clarity as to when the concept of reporting key audit matters.

Test Yourself Question

An audit manager was asked by the client to prepare the statement of cash flows and to draft certain new footnotes. The audit firm used software where the staff downloaded the client's trial balance to audit software. As a matter of course, lead sheets were produced. The audit software also downloaded the adjusted numbers into the form of financial statements. The footnotes were in a separate word document which was carried forward from the prior year. The audit manager read the foot notes to determine if changes were needed and new numbers were inserted from the current year audit as appropriate. The firm also included the cash flow statement that a staff member prepared in the financial statements. The client provided quarterly financial statements to the board of directors that they prepared internally.

When completing the independence checklist which should the auditor document?

a. Nonaudit services- assistance with preparation of financial statements

b. Nonaudit services- preparation of financial statements in their entirety

c. Nonaudit services- preparation of financial statements in their entirety and safeguards

Test Yourself Question, Solution

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Uniform Guidance Revisions

- OMB has issued a request for information asking for ideas on future revisions to *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).
- ED expected in summer of 2023. Intent is a full update to:
    1. Revise guidance to incorporate statutory requirements and administration priorities
    2. Revise guidance to reduce agency and recipient burden;
    3. Clarify guidance by addressing sections that recipients or agencies have interpreted in different ways
    4. Clarify guidance by rewriting applicable sections in plain English, improving flow, and addressing inconsistent use of terms.

Compliance Supplement 2023

- Compliance supplement for 2023 is expected to be issued in May 2023
- New programs expected of IIJA funding
- Other changes expected in Part 3 for Build America, Buy America under procurement
- The BABA was enacted as part of the IIJA on November 15, 2021.
- It established a domestic content procurement preference for all Federal financial assistance obligated for infrastructure projects after May 14, 2022.

Compliance Supplement 2023

- The domestic content procurement preference requires that all iron, steel, manufactured products, and construction materials used in covered infrastructure projects are produced in the United States.
- IIJ programs are expected to be designated “higher risk” in 2023
- Some COVID programs will stay on the “higher risk” list
- FAC is transitioning from Census to the General Services Administration (GSA) on 10/1/23 (deferred date)

New Audit Guide from Department of Education

- Department of Education has recently issued an updated Guide titled, 2023 Guide for Financial Statement Audits of Proprietary Schools and For Compliance Attestation Examination Engagements of Proprietary Schools and Third-Party Servicers Administering Title IV Programs (Guide), that is effective for fiscal years beginning on or after January 1, 2023.
  - Affects for profit entities
  - https://www2.ed.gov/about/offices/list/oig/nonfed/2023auditguide.pdf

Emphasis points on Pandemic Funding:

- Continue to ask questions of clients who may have failed to identify funding.
- Funding could be handled by departments that are not used to reporting it to accounting or grants management.
- Be aware of lost revenue rules.
- Be sure funding is appropriately identified on the SEFA and DCF.

2022 Compliance Supplement

- Compliance Supplement for 2022 was issued on May 12, 2022.
- Effective for June 30, 2022 year ends through March 31, 2023 year ends.
- Appendix V provides a high- level overview of the changes to the Supplement
- Part 2 - Matrix of Compliance Requirements- Pick 6 still applies
  - Programs with shifts are highlighted in yellow and bolded.
- Appendices are very useful, especially:
  - IV Internal Reference Tables
  - V List of Changes for the 2022 Compliance Supplement
  - VII Other Audit Advisories

2022 Compliance Supplement

Several new programs:

- 14.888 Lead-Based Paint and Housing-Related Hazards Capital Fund
- 59.075 Shuttered Venue Operators Grant
- 93.671 Family Violence Prevention and Services
- 21.023 Emergency Rental Assistance Program ☆ **Higher risk program**
- 21.026 Homeowner Assistance Fund Program
- 21.029 Coronavirus Capital Projects Fund
- 32.009 Emergency Connectivity Program ☆ **Higher risk program**

The Coronavirus Relief Fund (CRF) (21.019) is no longer identified as a higher risk program in the Supplement.

Higher Risk Programs- 2022

Agency	Assistance Listing (CFDA) Number	Title
Education*	84.425	Education Stabilization Fund
FCC*	32.009	Emergency Connectivity Fund Program
HHS*	93.461	Testing for the Uninsured
HHS*	93.498	Provider Relief Fund
HHS**	93.778/93.777/93.775	Medicaid Cluster
Transportation**	20.106	Airport Improvement Program
Transportation**	20.500/20.507/20.525/20.526	Federal Transit Cluster
Transportation**	20.315	National Railroad Passenger Corporation Grants
Treasury*	21.023	Emergency Rental Assistance
Treasury*	21.027	Coronavirus State and Local Fiscal Recovery Funds

Note:
* These programs were created by one of the laws cited at the beginning of this section and are thus considered 100% COVID-19 funding.
** These programs were existing programs that received additional funding from one or more of the laws cited at the beginning of this section.

Emphasis Points for 2023

- More oversight from Federal Agencies
- More findings expected related to COVID funding and new or inexperienced auditees
- Issues with FAC submissions
  - Amounts on SEFA do not match DCF
  - DCF does not properly identify major programs being audited
  - Required SEFA elements such as cluster names and totals, COVID funding, direct/indirect award etc are not always properly identified on DCF
- Make a thorough review of DCF.

Emphasis Points for 2023

- Issues noted with internal control over compliance
  - Consider nature and cause of deviations
  - Rare to have isolated incidents, consider findings for deviations and risk of fraud
  - Deviations may also result in larger compliance sample.
  - Every deviation should be investigated.
- Issues with dual purpose testing
  - Appropriate population is not always used
  - Confusion in what is a control test vs. compliance test
  - Ensure sample size is the large of the 2 if they had been tested separately.
  - Reconsider compliance sample in light of control testing

Emphasis Points for 2023

- FAQ on questioned costs
  - Questioned costs are defined in the UG as:
    - Costs that result from a violation or possible violation of a stature, regulation or terms and conditions of a federal award
    - Costs that are not supported
    - Costs that appear unreasonable
  - Not all findings lend them selves to quantifiable questioned costs
  - QC are reported if known > $25,000. Likely questioned costs are not reported in terms of the amount but the known is reported when a likely questioned cost extrapolates > $25,000.
  - Use proportional method (proportion % of QC to sample times population) or deviation percentage times population.

Emphasis Points for 2023

- Auditor performs compliance audit but not financial statement audit
  - Cannot issue “in relation to” opinion
  - Opinion on the SEFA using AU-C 805
- When compliance supplement is not available the auditor uses Part 7 to build the audit program. The auditor is not allowed to “pick 6”.
- Be careful to report findings the way they are outlined in the UG.
  - To be safe write the caption (criteria, cause, etc) at the top of the narrative
  - Be sure that the DCF and Schedule of Findings and Questioned costs have the correct numbers on them that tie to the SEFA.

Emphasis Points for 2023

- Increase in auditors receiving letters and other requests from federal agencies
- ED for SFA program
- HHS on situations where PRF was reported on SEFA prior to HHS guidance aligning reporting to submissions to the PRF reporting portal
- When requests involve access to audit documentation, refer to Interpretation 1 *Providing Access to or Copies of Audit Documentation to a Regulator* (AU-C 9230)

Emphasis Points for 2023

- Use Interpretation 1 of AU-C 230 (AU-C 9230)
  - Advise the client of the request
  - Make arrangements with the regulator
  - Maintain control over documentation
  - Consider submitting the letter described in para .05 of the interpretation to the regulator (discusses topics such as audit, confidentiality of workpapers and that the audit did not anticipate regulator asking for documentation).
- Auditors are not permitted to sign statements, certifications or provide assertions about information not included in the single audit. This is management's responsibility.

Reminders

- **Post event evaluation:** Please complete the course evaluation that will be viewable once the session ends. We welcome your feedback!