Current Matters Update 2014

Presented by

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Agenda

Agenda (continued)

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Overview of Recently Issued ASUs

- **Update No. 2014-01 – Investments – Equity Method and Joint Ventures (Topic 323):** Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force) – Relates to low-income housing tax credits

- **Update No. 2014-02 – Intangibles – Goodwill and Other (Topic 350):** Accounting for Goodwill (a consensus of the Private Company Council) – The PCC goodwill alternative

- **Update No. 2014-03 – Derivatives and Hedging (Topic 815):** Accounting for Certain Receive – Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach (a consensus of the Private Company Council) – PCC on hedging arrangements

- **Update 2014-04 – Receivables-Troubled Debt Restructuring by Creditors (Subtopic 310-40):** Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)

Overview of Recently Issued ASUs (Continued)

- **Update No. 2014-05 – Service Concession Arrangements (Topic 853)** (a consensus of the FASB Emerging Issues Task Force)

- **Update No. 2014-06 – Technical Corrections and Improvements Related to Glossary Terms** – Deleted duplicate terms

- **Update No. 2014-07 – Consolidation (Topic 810) Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)** – PCC alternative for real estate VIEs

- **Update No. 2014-08 – Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360):** Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity – Narrows focus on what qualifies as discontinued operations

Overview of Recently Issued ASUs (Continued)

- Update No. 2014-09 – Revenue from Contracts with Customers (Topic 606) – The new revenue recognition standard, a little light reading over 700 pages

- **Update No. 2014-10 - Development Stage Entities (Topic 915)** Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation- Basically eliminates development stage company reporting concept

- **Update No. 2014-11 – Transfers and Servicing (Topic 860):** Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

- **Update No. 2014-12 – Compensation-Stock Compensation (Topic 718):** Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)

Overview of Recently Issued ASUs (Continued)

- Update No. 2014-13 – Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity (a consensus of the FASB Emerging Issues Task Force)
- Update No. 2014-14 – Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)
- Update No. 2014-15 – Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern
- Update No. 2014-16 – Derivatives and Hedging (Topic 815). Determining whether the host contract in a hybrid financial investment issued in the form of a share is more akin to debt or to equity (a consensus of the FASB Emerging Issues Task Force).
- Update 2014-17 – Business Combination (Topic 805). Pushdown accounting (a consensus of the FASB Emerging Issues Task Force).

What is the Private Company Council?

The Financial Accounting Foundation (FAF) established the Private Company Council (PCC) in 2012 to work with the Financial Accounting Standards Board (FASB) to improve the process of setting accounting standards for private companies.

The PCC's primary responsibilities are to:

1. Determine whether and when alternatives to U.S. GAAP should be considered for private companies and
2. Act as the primary advisory body to the FASB for private company matters on the FASB's current technical agenda.

The PCC is comprised of a 9 - 12 (currently 10) member board which meets at least 5 times a year.

The accounting alternatives approved by the PCC are **optional** for private companies.

PCC standards are issued so far have exempted not-for-profits from their scope.

ASU 2013-07 Liquidation Basis of Accounting

- FASB ASU 2013-7, issued in April 2013, clarifies when to use the liquidation basis of accounting
- Applies to all entities issuing U.S. GAAP financial statements with the exception of investment companies registered under 1940 Act
- Requires entities to prepare financial statements using the liquidation basis of accounting when liquidation is imminent
- Liquidation basis is still considered U.S. GAAP and therefore an unmodified opinion can still be issued
- If comparative financial statements are presented, the auditor should add an emphasis of a matter paragraph if previous years were prepared using the going concern basis
- Effective for annual reporting periods beginning after December 15, 2013
- Early adoption is permitted (we have early adopted on at least one engagement)

ASU 2013-07 (Continued)

Liquidation is imminent when the likelihood is remote that either:

- A plan for liquidation has been approved by the person or persons having authority to make such a plan effective the execution of the plan will be blocked by other parties or the entity will return from liquidation or

- A plan for liquidation is imposed by other forces (such as involuntary bankruptcy) and the likelihood is remote that the entity will return from liquidation

ASU 2013-07 (Continued)

Liquidation Basis Presentation:

- Financial statements – there are two new basic financial statements; Statement of Net Assets in Liquidation and Statement of Changes In Net Assets in Liquidation
- Two column income statement may be necessary as the liquidation basis is applied from the date that liquidation is imminent
- Entities can also chose to present liquidation basis only statements, from the date of the liquidation forward to avoid a two column income statement

ASU 2013-07 (Continued)

Sample Liquidation Basis Opinion:

We have audited the accompanying financial statements of ABC Corporation, which comprise the statement of net assets in liquidation as of December 31, 20XX, the related statement of changes in net assets in liquidation for the period April 1, 20Xx to December 3, 20XX and the statements of income, changes in stockholders' equity and cash flows from January 1, 20XX to March 31, 20XX, and the related notes to the financial statements.

ASU 2014-08 Reporting Discontinued Operations

These amendments in this update affect an entity that has either of the following:

1. A component of an entity that either is disposed of or meets the criteria to be classified as held for sale.

2. A business or non profit activity (non profit activity was added as a result of this amendment) that, on acquisition, meets the criteria to be classified as held for sale.

ASU 2014-08 (Continued)

A discontinued operation may include a component of an entity, a group of components of an entity or a business or nonprofit activity.

A component of an entity comprises operations and cash flow that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Components of an entity may be:

- A reportable segment
- An operating segment
- A reporting unit
- A subsidiary
- An asset group

ASU 2014-08 (Continued)

A disposal of a component of an entity or group of components of an entity is required to be reported as discontinued operations if the disposal represents a **strategic shift** that has (or will have) a **major effect on the entity's operations** and financial results when any of the following occur:

1. The component of an entity meets the criteria for held for sale
2. The component of an entity is disposed of by sale or
3. The component of an entity is disposed of other than by sale (abandonment, distribution to owners in a spinoff)

ASU 2014-08 (Continued)

Examples of a Strategic Shifts:

- Disposal of a major geographic area - example no longer selling goods or services in the Southwest
- Disposal of a major line of business – Company has 5 product lines that have clear operations and cash flows. Company terminates or sells a product line.
- Disposal of a major equity method investment.
- Disposal of other major parts of an entity.

ASU 2014-08 (Continued)

The amendments of this ASU require additional disclosures about discontinued operations including:

- The major classes of line items that constitute pretax profit or loss (change in net assets for NFP entity) of discontinued operations for the periods in which results of operations of the discontinued operations are presented.
- The total operating and investing cash flows of the discontinued operations or the depreciation, amortization, capital expenditures and significant operating and investing noncash items of the discontinued operations for the periods in which results of operations are reported.
- If discontinued operations includes a non controlling interest, the pretax profit or loss attributable to the parent for the periods in which discontinued operation are presented.
- A reconciliation of the major classes of assets and liabilities of the discontinued operations held for sale that are disclosed in the notes to financial statements to total assets and total liabilities of disposal group classified as held for sale that are presented on the face of the financial statements.
- A reconciliation of the major classes of line items constituting the pretax profit or loss of the discontinued operation that are disclosed in the notes to financial statements to the after-tax profit or loss of the discontinued operations that is presented on the face of the statement where net income is reported for periods in which the results of operations of the discontinued operation are presented.
- Requirement of no significant continuing involvement has been removed

ASU 2014-08 (Continued)

Main differences from current GAAP:

- Only the disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations an financial results will be reported as discontinued operations.

- A business or non profit activity that, on acquisition, meets the criteria to be classified as held for sale is reported in discontinued operations. Current GAAP does not include a business or non profit entity in the definition of discontinued operations.

- A disposal of an equity method investment that meets the definition of discontinued operation is reported in discontinued operations. Currently disposals of equity method investments are not in scope.

ASU 2014-08 (Continued)

Effective date of Amendments:

All disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014 for public entities and December 15, 2014 for non public entities and interim periods within those years.

All businesses or non profit activities, that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014 for public entities and December 15, 2014 for non public entities and interim periods within those years.

Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance.

Revenue Recognition: Recently Issued ASU

The FASB/IASB Revenue Project

Supersedes ASC Topic 605 and most industry specific ASC rev rec guidance
Creates New Topic 606
Clarify the principles
One common revenue standard
Remove inconsistencies and weaknesses
Provide robust framework
Improve comparability
Provide useful information to users through improved disclosure requirements
Simplify preparation – reduce the number of revenue requirements companies must refer to

New Revenue Definition and Concepts

An entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

The concepts of earnings process and realization/realizability have been eliminated

Transferring of the promised goods is essential to the timing of revenue recognition

Entitled is essential to the measurement

The Five Step Process of Recognizing Revenue

1. Identify contract(s) with customers
2. Identify separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue when or as performance obligations are satisfied

Step 1: Identify the Contract(s)

A contract is an agreement between two or more parties that creates enforceable rights and obligations

May be written, verbal or customary (implied by entity's normal business practices)

A contract does not exist if both parties can cancel wholly unperformed contract without penalty

The rights and obligations must be enforceable – may be a matter of law and may vary within industry and jurisdiction

Step 1: Identify the Contract(s)

Requirements for a contract:

- Approval and commitment of the parties
- Identification of the rights of the parties
- Identification of the payment terms
- Contract has commercial substance
- It is probable that the entity will collect the consideration to which it will be entitled

Step 1: Identify the Contract(s)

Combining Contracts:

Certain contracts should be combined if:

- Entered into at or near same time with same customer

And one or more of the following is met:
- Contracts are negotiated as a package with a single commercial objective, or
- Consideration to be paid in one is dependent on price/performance in the other, or
- Goods and services promised are a single performance obligation

Step 1: Identify the Contract(s)

Contract Modifications:

- Contract modification is change in scope or price (or both)
- Must be approved by both parties (ignore until approved)
- Account for as a separate contract if:
  - Scope increases due to addition of distinct goods or services, and
  - Price change reflects standalone selling prices
- Termination of existing and creation of new contract if:
  - Remaining goods/services are distinct from those already transferred
  - If not, treat as part of existing contract

Step 2: Identify Performance Obligation(s)

A promise to transfer a good or service to a customer

Can be:

Explicitly stated

Implied by the entity's customary business practice

Is identified at contract inception

Step 2: Identify Performance Obligation(s)

- Is a separate performance obligation, or a series of distinct goods or services that are substantially the same that can benefit the customer
- Distinct = capable of being distinct and distinct within the context of the contract
- Capable of being distinct = customer can benefit on its own or with other resources readily available to the customer
- Context of contract = no significant integration or goods/services not highly interrelated
- Benefit the customer = can be used, consumed, sold for > scrap or held to generate economic benefits

Step 3: Determine the Transaction Price

- Transaction price is the amount of consideration to which the selling entity expects to be entitled

- Terms of the contract and customary business practices should be considered

- Assume the goods and services will be transferred to customer as promised

Step 3: Determine the Transaction Price

Issues to consider:

- Variable consideration and constraint
- Significant financing components
- Noncash consideration
- Consideration payable to a customer

Step 3: Determine the Transaction Price

- Variable consideration may be a result of discounts, rebates, refunds, credits, incentives, performance bonuses/penalties, royalties, price concessions, rights of return or similar items.
- Estimate the transaction price using either the expected value or the most likely amount (whichever method is best predictive)
- Expected value = sum of probability-weighted amounts in a range of possible amounts
- Most likely amount = the single most likely amount from two or more possible outcomes
- Consider all information reasonably available in making and updating the estimate

Step 3: Determine the Transaction Price

Constraint on variable consideration:
Include variable consideration only to the extent that it is probable a significant reversal of cumulative revenue recognized will not occur when the uncertainty is resolved. Consider the following:

- Variable consideration is highly susceptible to factors outside entity's influence such as volatility in market, third party actions, weather, high risk of obsolescence)
- Uncertainty will not be resolved for a long period of time
- Entity's experience with this type of contract is limited and of little predictive value
- Entity has practice of broad range of concessions
- Contract has large number of possible consideration amounts

Note that variable consideration rules don't apply to sales or usage-based royalties on IP licenses. These are recognized when the subsequent sales or usage occurs.

Step 3: Determine the Transaction Price

Is there a significant financing component in the contract?

- Consider anticipated time frame between transfer and payment
- Consider interest rate in contract and prevailing interest rates in market

If yes, discount rate should reflect what a separate financial transaction between parties would be at the contract inception and reflect characteristics of the party receiving

Step 3: Determine the Transaction Price

Is there noncash consideration?

- Measure at fair value of noncash consideration
- If can't reasonably estimate fair value, measure indirectly by reference to standalone selling price of goods/services to be delivered
- If assets are contributed by customer to facilitate fulfillment of contract, treat as noncash consideration received if entity receives control over the assets

Step 3: Determine the Transaction Price

Is there consideration payable to the customer?

- If paid for a distinct good, treat as a purchase in the ordinary course of business
- If not paid for a distinct good, treat as a reduction of the transaction price and revenue

Step 4: Allocating the Transaction Price

Allocation of the transaction price of a contract to the contract's separate performance obligations is:

- Determined at contract inception
- Applied to goods / services underlying each separate performance obligation
- Analyze standalone price if performance obligation sold separately
- Start with actual observable price, if available
- Estimate using observable inputs if observable price not available

Approaches to estimating:

- Adjusted market assessment approach- estimate the price a customer would be willing to pay for the separate performance obligation
- Expected cost plus margin approach
- Residual approach if standalone selling price is highly variable or uncertain

Note: Software VSOE rules are gone.

Step 4: Allocating the Transaction Price

Is sum of standalone selling prices for each performance obligation greater than the total transaction price (discount)?

- Generally allocate discount to separate performance obligations proportionally unless the observable selling prices provide evidence to where the entire discount belongs

Is there variable consideration?

- Generally allocate the variable consideration to the distinct goods/services to which it relates

Step 5: Recognizing Revenue

Revenue is recognized when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when (or as) the customer obtains control of that asset.

- Transfer of control is determined on the basis of indicators
- Control refers to the ability to direct the use and obtain substantially all of the remaining benefits
- Benefits are the potential cash flows that can be obtained directly or indirectly
- Control includes the ability to prevent other entities from directing the use of and obtaining benefits from the asset

Step 5: Recognizing Revenue

Indicators of Transfer of Control:

- The seller entity has a right to payment for the asset
- The customer has legal title to the asset
- The seller entity has transferred physical possession of the asset
- The customer has the significant risks and rewards of ownership of the asset
- The customer has accepted the asset

Step 5: Recognizing Revenue

For each performance obligation identified, determination must be made at inception as to whether satisfaction is:

- Over time- by transferring control of a promised good/service over time, or
- A point in time- if the performance obligation is not satisfied over time, the performance obligations is satisfied at a point in time.

Step 5: Recognizing Revenue

An entity transfers control of a good/service over time and satisfies a performance obligation and recognizes revenue over time if one of the following criteria is met:

- The customer simultaneously receives and consumes the benefits as the entity performs, or
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced, or
- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

Related definitions:

- An asset does not have an alternative use if the seller entity is restricted contractually or practically from redirecting the asset to another use (including selling to another customer)
- Right to payment considers the idea of an enforceable right to payment for performance completed to date- does not need to be for a fixed amount

Step 5: Recognizing Revenue

Performance obligations satisfied over time are recognized by measuring progress towards completion if reasonably measurable. Method used should be consistent for a performance obligation. Select a method that best depicts performance for each performance obligation.

- Output methods: direct measurement of the value to the customer for transfers to date (surveys of performance, milestones, units delivered, etc.)
- Input methods: recognized based on effort to satisfy (costs incurred, labor hours, etc.)

Other Items

- Disclosures- significant qualitative and quantitative
- Effective calendar 2017 for public; 2018 or 2017 for private
- Transition: either full retrospective or cumulative effect at date of adoption or retrospective with some practical expedients
- Resources: AICPA Industry Task Forces, AICPA guide for industry specific with goal of Summer 2016, FASB Joint (with IASB) Transition Resource Group, big 4 webinars and printed materials, AICPA 26-page Financial Reporting Brief
- Full ASU is 700 pages long and includes 63 examples covering a number of situations and industries

ASU 2014-15 Going Concern

This ASU provides guidance about *management's* responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosure.

Management's evaluation of substantial doubt about the entity's ability to continue as a going concern must extend to at least **one year after the date that the financial statements are issued or available to be issued.**

Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is *probable* that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued or available to be issued.

ASU 2014-15 (Continued)

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, but substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose the following:

a) Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern

b) Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.

c) Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

ASU 2014-15 (Continued)

If substantial doubt about an entity's ability to continue as a going concern is not alleviated after consideration of management's plans, the entity should include a statement in the footnotes that there is substantial doubt about its ability to continue as going concern within one year after the date the financial statements are issued or available to be issued and disclose the following:

a) Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

b) Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.

c) Management's plans that are intended to mitigate the conditions or events that raise substantial doubt.

ASU 2014-15 (Continued)

The amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted.

Proposed ASU - Leases

Currently in second exposure draft-redeliberation.

The proposed definition of a lease:

A contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Proposed ASU on Leases (Continued)

An entity would determine whether a contract contains a lease by assessing the following:

1. The use of an identified asset is either explicitly or implicitly specified. A contract would not involve an identified asset if a supplier has the substantive right to substitute the asset used to fulfill the contract. A supplier would have the substantive right to substitute of a) it has the practical ability to substitute the asset and b) it can benefit from exercising the right of substitution.

2. The customer controls the use of the asset. A contract conveys the right to control the use of the identified asset if, through the period of use the customer has the right to a) direct the use of the identified asset and b) obtain substantially all of the economic benefits from directing the use of the identified asset.

Proposed ASU – Lease (Continued)

- Would record all leases over 12 months on the balance sheet, both capital (financing) leases (Type A) and operating leases (Type B)
- Type A Balance Sheet - Right-of-use asset, lease liability
- Type A Income Statement – Amortization expense and interest expense
- Type A Cash Flow Statement – Cash paid for principal and interest payments
- Type B Balance Sheet – Right-of-use asset, lease liability
- Type B Income statement – single lease expense on a straight line basis
- Type B Cash Flow Statement – cash paid for lease payments

Proposed ASU – Customer's Accounting for Fees Paid in Cloud Computing Arrangement

Examples of cloud computing arrangements:

- Software as a service
- Platform as a service
- Infrastructure as a service
- Other hosting arrangements

Proposed ASU – Customer's Accounting for Fees Paid in Cloud Computing Arrangement (Continued)

The proposal updates guidance for customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer would account for the software license element of the arrangement consistent with the other software licenses.

If a cloud computing arrangement does not include a software license, the customer would account for the arrangement as a service contract.

The proposal would be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015 for public business entities and annual periods beginning after December 15, 2015 and interim periods for annual periods beginning after December 15, 2016 for all other entities. Early adoption would be permitted.

Entities would apply this amendment either (1) prospectively to all arrangements entered into or materially modified after the effective date, or (2) retrospectively.

Proposed ASU – Extraordinary and Unusual Items

The amendment would eliminate from GAAP the concept of extraordinary items and the requirements to:

- Segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of taxes.
- Disclose applicable income taxes.
- Present or disclose earnings-per-share data applicable to the extraordinary item.

The amendments would be applied prospectively for extraordinary items in annual periods, and interim periods within those annual periods, beginning after December 15, 2015.

Early adoption would be permitted.

Proposed ASU – Simplifying the Measurement of Inventory

The amendment proposes that inventory be measured at the lower of cost and net realizable value.

Net realizable value is defined in the Master Glossary as the "estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation".

The amendment would eliminate the requirement to consider replacement cost of inventory and net realizable value of inventory, less an approximate normal profit margin.

The proposed amendment would be applied prospectively for the measurement of inventory in annual periods, and interim periods within those annual periods, beginning after December 15, 2015.

Early adoption would be permitted.

Proposed ASU – Retirement Benefits

The proposal provides practical expedient for the measurement date of an employer's defined benefit obligation and plan assets when the fiscal year end does not fall on a month end.

The proposed ASU permits employers to measure defined benefit plan assets and obligations as of the month-end closest to the entity's fiscal year end and to follow that measurement date methodology consistently from year to year.

Contributions to plan assets made between the date used to measure the plan assets and benefit obligations and an entity's fiscal year end would be adjustments of the funded status recognized in the statement of financial position, reflecting the contributions as an addition to plan assets (for those made after the measurement date but before year end) or as a deduction from plan assets (for contributions made after fiscal year end but before the measurement date).

Proposed ASU – Retirement Benefits (continued)

Classes of plan assets and the fair value hierarchy would not be adjusted for the effects of the contributions. The amounts of the contributions would be presented apart from the classes of plan assets and the fair value hierarchy to permit reconciliation to the ending fair value of plan assets.

The proposed amendment would be applied prospectively. An effective date has not yet been proposed.

Proposed ASU – Simplifying the Presentation of Debt Issuance Cost

This proposed update would require debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs would not be affected by the proposed amendments.

The proposal would be applied on a retrospective basis, wherein the balance sheet of each period presented would be adjusted to reflect the new guidance. The effective date of this proposed amendment has not been determined.

Financial Statements of Not-For-Profit Entities
Statement of Activities

<u>Net Asset Classes</u>

- Replaced the existing requirements of paragraphs 958-225-45-1 to present the change in each of three net asset classes on the face of a statement of activities with similar requirements for two classes of net assets: (1) with donor-imposed restrictions and (2) without donor-imposed restrictions. The Board also decided to make conforming changes to the terminology and definitions of the net asset classes.
- Related disclosures:
  - Retained the current requirement to provide information about the changes in the nature and amounts of different types of donor-imposed restrictions but modify the requirement to (a) remove the hard-line distinction between temporary restrictions and permanent restrictions and (b) focus instead on describing differences in the nature with an emphasis on changes in how and when the resources (net assets) can be used.

    Required disclosure of information about the amount and purposes of board designations of net assets without donor-imposed restrictions.

<u>Intermediate Measure of Operations, including presentation requirements</u>

Definition

- An NFP would be required to present an intermediate measure of current operations that is defined on the basis of two key dimensions: a **mission** dimension and an **availability** dimension.

Statement of Activities (continued)

Definition (continued)

- The mission dimension is based on whether resources are (result) from or directed at carrying out an NFP's purpose for existence.
- The availability dimension is based on whether resources are available for current period activities that reflect both external and internal limitations.

Implementation Guidance

- Guidance for the mission dimension would note that (a) all gifts result from carrying out the NFP's activities but are not necessarily available for current period activities, (b) all legally available mission related revenues are to be presented before reductions for amounts designated by the governing board for use in future periods (rather than only the net of those amounts), (c) investing and financing activities, other than those directed at carrying out the NFP's programs, would *not* meet the mission dimension (and thus, fall outside of the intermediate measure of operations).
  - Investing and financing activity directed at carrying out the NFP's programs, sometimes referred to as *programmatic investing*, would include items such as interest earned on an educational institution's student loans, a foundation's subsidized loans to support grantees, and similar lending directed at achieving the NFP's purposes.

Statement of Activities (continued)

Implementation Guidance (continued)

- Guidance for the availability dimension would note that (a) external limits often result from donor-imposed restrictions that limit the availability of donated resources for current period use until such restrictions are met and (b) internal limits often result from actions of an NFP's governing board to designate resources for specific (limited) purposes or future periods and similar actions that effectively make resources unavailable for current operations.
- For example, an NFP would initially report all bequests as operating revenue and would report a transfer out of current operations for the amount of the bequest that the governing board has designated to be invested in the quasi-endowment, thus making the bequest unavailable for current operations.

Statement of Activities (continued)

Implementation Guidance for Treatment of Capital-like Transactions

- An NFP would initially report the gift of long-lived assets without donor restrictions as operating revenue. If the NFP places the asset in service (instead of selling it), the NFP would also report a transfer out of operations for the entire amount of the gifted long-lived asset.
- Similarly, gifts of cash that a donor has restricted for the acquisition or construction of long-lived assets would initially be reported as revenues that increase net assets with donor restrictions, which are reported outside of operations. When the asset is placed in service, the release of the donor restriction would be reported as an increase in net assets without donor restrictions within operating activity and a decrease in net assets with donor restrictions. Consistent with the treatment of gifts of long-lived assets placed in service, that amount would also be reported as a transfer from operations to nonoperating activities.

Statement of Activities (continued)

Presentation matters related to the intermediate measure

- NFPs must present (1) all transfers in a separate, discrete section and (2) a subtotal of operating revenues and expenses before such transfers, which is in addition to the decision to require an intermediate measure of operations (which is an amount after such transfers). At a minimum, an NFP must present the aggregate of transfers out of operating activities separate from the aggregate of transfers into operating activities. Unless the NFP chooses to display all transfers as discrete line items on the face of the statement of activities, the NFP would need to provide details for aggregated transfers in a note. All NFPs would be required to describe qualitatively the purpose, amounts, and types of transfers (for example, those done because of standing board policies, as one-time decisions, or for other reasons).
- Business-oriented health care providers would be permitted, but no longer required to present the performance indicator that is currently required by paragraph 954-225-45-4.
- An NFP would continue to be allowed to use a one or two statement approach to present all of the revenues, expenses, gains, losses and other events that change net assets or classes of net assets for the period. An NFP is permitted but would not be required to report the intermediate measure of operations in a statement that also reports the change in unrestricted net assets for the period, as currently required by paragraph 958-225-45-10. Accordingly, when using a two statement approach the first statement could end with the intermediate measure of operations.

Statement of Activities (continued)

Expiration of Restrictions

- Required that an NFP use the placed-in-service approach for the treatment of expiration of restrictions related to long-lived assets, thus eliminating the option to release the donor-imposed restriction over an asset's estimated useful life.

Reporting of Expenses

- Required all NFPs to report expenses by both their nature and function but allowed flexibility to present expenses either by function or nature (or by both) on the face of the statement of activities or within the notes. Accordingly, voluntary health and welfare organizations would be permitted but no longer required to present a separate statement of functional expenses.
- Required all NFPs to provide an analysis of expenses by function and by nature in one location, but that location and format is flexible and likely would be included within the notes. Investment expenses that are netted against investment return need not be included and other nonoperating expenses (for example, interest and other financing expenses) need not be functionalized.
- Required all NFPs to include a description of the method used to allocate costs among program and support functions.

Statement of Activities (continued)

Reporting of Expenses

- Board will refine the definition of *management and general activities* and include additional illustrative guidance to better depict which types of costs should be allocated among program and/or support functions.

Investment Return

- Required a net presentation of investment expenses against investment return on the face of the statement of activities. Required external and direct internal investment expenses to be netted against the investment return.
- Related Disclosure (removed):
  - Removed the requirement in current GAAP (paragraph 958-225-50-1) to disclose netted investment expenses
  - Required the disclosure of the amount of internal salaries and benefits, if any, that have been netted against investment return.

Statement of Financial Position

<u>Net Asset Classes</u>

- Replaced the existing requirements of paragraphs 958-210-45-1 to present totals for each of three classes of net assets on the face of a statement of financial position with similar requirements for two classes of net assets (1) with donor- imposed restrictions and (2) without donor-imposed restrictions. The Board also decided to make conforming changes to the terminology and definitions of the net asset classes.

- Related Disclosures:
  - Modified the current requirement to provide information about the nature and amounts of different types of donor-imposed restrictions to (a) remove the hard-line distinction between temporary restrictions and permanent restrictions and (b) focus instead on describing differences in the nature with an emphasis on both how and when the resources (net assets) can be used.
  - Required disclosure of information about the amount and purposes of board designations of net assets without donor-imposed restrictions.

Statement of Cash Flows

- Required the direct method of reporting cash flows provided [used] by operating activities and removed the requirement to reconcile the change in net assets to net cash flow from operating activities (indirect method).
- Reclassified the following cash inflows and outflows to better align the categories used in the cash flow statement with those proposed for the statement of activities:
  - Cash gifts with donor-imposed restrictions that they be used to purchase, construct, or otherwise acquire long-lived assets for operating purposes from *financing* to *operating*
  - Cash payments to purchase, construct, or otherwise acquire long- lived assets for operating purposes from *investing* to *operating*
  - Cash proceeds from the sale of long-lived assets from *investing* to *operating*
  - Cash dividends and interest income from *operating* to *investing*
  - Cash payments of interest expense from *operating* to *financing*.

Note Disclosures
(not specifically related to one statement)

Liquidity

- Required an NFP to provide quantitative and qualitative information useful in assessing liquidity, including a description of the time horizon it uses to manage its liquidity.
- Quantitative information would include the (1) total amount of financial assets, (2) amounts that, due to various limitations, are not available to meet cash needs within the NFP's time horizon, and (3) total amount of financial liabilities that are due within that time horizon. Qualitative information includes information about how an entity manages its liquidity.

Underwater endowments

- Require that the so-called underwater amounts be reported within the proposed *with donor restrictions* class of net assets (rather than unrestricted class of net assets as currently required).
- An NFP also would be required to disclose the following information:
  - The board's policy or decision on whether to reduce or not spend from underwater endowment funds
  - Original gift amount (or level required by donor stipulations or law) of underwater endowment funds in the aggregate
  - Fair value of underwater endowment funds in the aggregate.

Note Disclosures (continued) (not specifically related to one statement)

Other

- Directed the staff to develop more streamlined examples of note disclosures that meet current GAAP requirements, particularly for the intersection of requirements surrounding investments, endowment net assets, and fair value levels.
- Business-oriented NFP health care entities no longer have to disclose their tax-exempt status in accordance with paragraph 954-740-50-1.

Tax Matters

Matters noted in the first quarter update of the 2014-2015 IRS, Treasury Priority Guidance Plan (November 7, 2014).

Exempt Organizations

1. Revenue procedures updating grantor and contributor reliance criteria under §§170 and 509.
2. Revenue procedure to update Revenue Procedure 2011-33 for EO Select Check.
3. Regulations under §§501(a), 501(c)(3), and 508 to allow the Commissioner to adopt a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under §501(c)(3). [PUBLISHED 07/02/14 in FR as TO 9674 (FINAL and TEMP) and REG-110948-14 (NPRM)].
4. Revenue procedure setting forth procedures for issuing determination letters on exempt status under §501(c)(3) to eligible organizations that submit Form 1023-EZ. [PUBLISHED 07/21/14 in IRB 2014-30 as REV. PROC. 2014-40].
5. Proposed regulations under §501(c) relating to political campaign intervention.

Tax Matters (continued)

Matters noted in the first quarter update of the 2014-2015 IRS, Treasury Priority Guidance Plan (November 7, 2014).

Exempt Organizations (continued)

6. Final regulations on application for recognition of tax exemption as a qualified nonprofit health insurer under §501(c)(29) as added by §1322 of the ACA. Temporary and proposed regulations were published on February 7, 2012.
7. Final regulations under §§501(r) and 6033 on additional requirements for charitable hospitals as added by §9007 of the ACA. Proposed regulations were published on June 26, 2012 and April 5, 2013.
8. Additional guidance on §509(a)(3) supporting organizations.
9. Guidance under §512 regarding methods of allocating expenses relating to dual use facilities.
10. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

Tax Matters (continued)

Matters noted in the first quarter update of the 2014-2015 IRS, Treasury Priority Guidance Plan (November 7, 2014).

Exempt Organizations (continued)

11. Final regulations under §§4942 and 4945 on reliance standards for making good faith determinations. Proposed regulations were published on September 24, 2012.
12. Final regulations under §4944 on program-related investments and other related guidance. Proposed regulations were published on April19, 2012.
13. Guidance regarding the excise taxes on donor advised funds and fund management.
14. Guidance under §6033 relating to the reporting of contributions.
15. Final regulations under §6104(c). Proposed regulations were published on March 15,2011.
16. Final regulations under §7611 relating to church tax inquiries and examinations. Proposed regulations were published on August 5, 2009.

Tax Matters (continued)

Proposed regulations relating to political campaign intervention:

- The Supreme Court's Citizens United decision in 2010 has led to a large influx of money into the election process.
- Raised questions about donor disclosure and political activities by 501(c)(4) organizations appearing to be involved in partisan political activities.
- In November 2013, Treasury issued proposed regulations to provide guidance and more definitive rules on political activity for 501(c)(4) organizations.
- The proposal stipulated that the prevention of social welfare does not include "candidate-related political activity" as defined.
- More than 169,000 comments were received to the November 2013 proposal – an incredible number.
- IRS released a statement May 22, 2014 that proposal will be reissued in a second …. In early 2015.

Tax Matters (continued)

Proposed regulations relating to political campaign intervention (continued):

- Forth coming proposal expected to address -
  - What should be the definition of political activity
  - To when should it apply, and
  - How much political activity an organization can engage in before jeopardizing its tax exemption.
- Obviously much interest in this topic including a tem of legal experts who formed the Bright Lines Project to address issues in this sphere.

Changes to Single Audit Environment

- The OMB Circulars for Single Audits have been codified and are now all included in 2 CFR Part 200.
- The short-hand to refer to 2 CFR Part 200 is "Super Circular" since it consolidates A-21, A-87, A-110, A-122, and A-133 circulars.
- Changes are effective for years *beginning* after December 15, 2014.
- The overall gist of the changes is to make everything a more formal, contract-like environment with uniform guidelines.

The Big Changes

- The threshold for the audit requirement will increase from $500K to $750K.
- The threshold to determine Type A versus Type B awards will increase from $300K to $750K.
- The Single Audit report, including the Schedule of Expenditures of Federal Awards and the Schedule of Findings and Questioned Costs will be available to the public via the Data Clearinghouse website at https://harvester.census.gov/facweb/Default.aspx.
- There will be an option to go with a flat 10% indirect rate.

Other Changes

- Fixed-price awards (as opposed to contracts) are a relatively new thing and are expected to become a lot more common. These won't have standard expense reporting but will emphasize accountability based on performance and results. Except in the case of termination before completion of the Federal award, there is no governmental review of the actual costs incurred by the recipient in performance of the award.

- The term "vendor" has gone away and is replaced by "contractor".

Other Changes (cont.)

- Procurement just got a whole lot harder.
  - The wiggle room of only seeking competition “to the maximum extent practical” has gone away and the threshold for needing to document competition is now $3,000. “Micro-purchases” of less than $3,000 don’t need competitive bids or price analysis.
  - MBE/WBE (Minority owned Business/ Woman owned Business) language that used to say use these businesses “wherever possible” now says “must take all necessary steps”.
  - If a recipient uses a contractor with an agreement of $150K or higher, the actual profit point worked into that agreement has to be negotiated separately. Per the CFR, “To establish a fair and reasonable profit, consideration must be given to the complexity of the work to be performed, the risk borne by the contractor, the contractor's investment, the amount of subcontracting, the quality of its record of past performance, and industry profit rates in the surrounding geographical area for similar work.”

Other Changes (cont.)

- Monitoring of subrecipients must now be “robust” and follow a system. Subrecipients must follow the same procurement rules as mentioned above.
- The detailed specifics about internal control are gone which increases the challenge of nonprofits making sure they are compliant but lets them create controls specific to their operations.
- Conflict of Interest now includes at the organizational level, meaning any unequal access to information (i.e. a previous grant gave you proprietary information that would give you undue advantage on a new grant) has to be disclosed to the federal agency.
- Employee morale is no longer an allowed cost.

The Change to the 14 Areas of Compliance

- When the changes in the Super Circular go into effect, the 14 areas of compliance will drop down to 13. The Real Property Acquisition and Relocation Assistance area will be removed.

- The provisions of OMB Circular A-110 are now found in 2 CFR part 215 but the best place to see the compliance requirements in detail is still the compliance supplement located at http://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2014

Questions?