NON-PROFIT UPDATE 2022
ACCOUNTING UPDATE

Presented by Cerini & Associates, LLP

ACCOUNTING STANDARDS UPDATE

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WHAT IS THE FASB AND WHY SHOULD WE CARE?

- Established in 1973.
- The Financial Accounting Standards Board (FASB) is the independent, private-sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow Generally Accepted Accounting Principles (GAAP).
- The seven members of the FASB serve full time and, to foster their independence, are required to sever connections with the firms or institutions they served before joining the Board.
- While the Board members of the FASB individually have diverse backgrounds, each has a concern for investors, other users, and the public interest in matters of accounting and financial reporting and they collectively have "knowledge of accounting, finance, business, accounting education, and research."
- **In short, the FASB creates and modifies the accounting rules that your organization has to follow to comply with GAAP.**

HOW DO THESE ACCOUNTING CHANGES HAPPEN?

- The Board identifies financial reporting issues based on requests/recommendations.
- The FASB decides whether to add a project to its technical agenda.
- The Board deliberates at one or more public meetings various reporting issues identified.
- The Board issues an Exposure Draft to solicit broad stakeholder input. (In some projects, the Board may issue a Discussion Paper to obtain input in the early stages of a project.)
- The Board holds a public roundtable meeting on the Exposure Draft, if necessary.
- The FASB analyzes comment letters, public roundtable discussions, and all other information obtained through due process activities.
- The Board redeliberates the proposed provisions, carefully considering the stakeholder input received, at one or more public meetings.
- The Board issues an Accounting Standards Update (ASU) describing amendments to the Accounting Standards Codification (ASC).

WHAT IS THE AICPA AND WHY SHOULD WE CARE?

- Established in 1887.
- The American Institute of Certified Public Accountants (AICPA) is the national professional organization of Certified Public Accountants (CPAs) in the United States, based in North Carolina, that sets ethical standards for the profession and United States auditing standards (GAAS) for audits of private companies, non-profit organizations, and federal, state, and local governments.
- Until the FASB was established, the AICPA set generally accepted professional and technical standards for CPAs. Upon the formation of the FASB, the AICPA transferred its responsibility for setting GAAP to the FASB. Following this transfer, the AICPA retained its responsibility for setting standards in areas such as financial statement auditing, professional ethics, attest services, etc.
- The Auditing Standards Board (ASB) is the AICPA's senior committee for auditing, attestation, and quality control applicable to the performance and issuance of audit and attestation reports. It serves the public interest by developing, updating, and communicating comprehensive standards and practice guidance that enable practitioners to provide high-quality, objective audit and attestation services.
- The standards issued by the AICPA are called Statements on Auding Standards (SAS).
- **<u>In short, the AICPA creates and modifies rules that CPAs must follow in performing and reporting on audits of your organization.</u>**

ACCOUNTING CHANGES TO BE DISCUSSED

- AICPA Technical Q&A 3200-18, *Accounting For A Forgivable Loan Received Under The US Small Business Administration Paycheck Protection Program*
- SAS No. 134*, Auditor Reporting*
- SAS No. 135*, Communication with Those Charged with Governance*
- SAS No. 136*, ERISA Audits*
- ASU 2016-02, *Leases*
- ASU 2020-07*, Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*
- ASU 2021-03*, Intangibles – Goodwill and Other: Accounting Alternative for Evaluating Triggering Events*
- ASU 2017-04, *Intangibles — Goodwill and Other: Simplifying the Test for Goodwill Impairment*
- ASU 2016-13, *Financial Instruments — Credit Losses: Measurement of Credit Losses on Financial Instruments.*
  - Related ASU's will be mentioned as well
- ASU 2018-14, *Changes to the Disclosure Requirements for Defined Benefit Plans*

ACCOUNTING FOR PAYCHECK PROTECTION PROGRAM (PPP) LOANS

- During June 2020, the AICPA and FASB collaborated to issue a Technical Q&A (TQ 3200-18) to provide guidance on the appropriate classification and accounting for PPP loans.

- Organizations have two options for classifying and accounting for PPP loans:
  - Classify the PPP loan as debt, pursuant to Accounting Standards Codification (ASC) 470, *Debt.*
    - Recognize the PPP loan payment as a debt liability and accrue interest pursuant to the loan's contractual terms.
    - Forgiveness income is recognized, and the debt liability extinguished/derecognized, when the United States Small Business Administration (SBA) formally approves the Organization's forgiveness application. Any amount not forgiven will continue to be accounted for as debt and repaid pursuant to the terms of the loan.
  - Classify the PPP loan as a refundable government grant, analogous to the treatment of conditional grants, pursuant to ASU 2018-08, which modifies ASC 958-605, *Not for Profit Entities – Revenue Recognition.*
    - Recognize the PPP loan payment as a refundable grant liability.
    - Forgiveness income is recognized when the conditions of loan forgiveness are met. In this case, the conditions of forgiveness comprise expending the PPP loan funds on qualifying expenses incurred during the covered period, ensuring the appropriate ratio of payroll to other qualifying costs incurred, and maintaining the required full-time-equivalent staffing levels, in accordance with the terms of the PPP loan.
    - This approach matches the timing of forgiveness income recognition to the timing of incurring the underlying expenses, analogous to a deficit funded grant.

STATEMENTS ON AUDITING STANDARDS (SAS) No. 134

- **Effective date: Due to COVID-19, AICPA ASB deferred to 2021 calendar year-end, 2022 fiscal year-end.**

- Changes the form and content for all auditors' reports under Generally Accepted Auditing Standards (GAAS). The changes are intended to enhance the communicative value and relevance of the auditors' report, including:
  - *Opinion* section of auditors' report to be presented first, followed by *Basis for Opinion* section.
  - Enhanced auditor reporting relating to going concern, including a separate section in the auditors' report when substantial doubt exists.
  - Expanded description of auditors' responsibilities, including those relating to professional judgment, skepticism, and communications with those charged with governance.
  - Auditors are required to communicate with those charged with governance about the significant risks identified by the auditor.

STATEMENTS ON AUDITING STANDARDS (SAS) No. 134

- Auditors may be engaged by those charged with governance to communicate key audit matters (KAMs) in the auditors' report. Those charged with governance decide whether the auditor reports on KAMs in the auditors' report. Auditors are **not** required to communicate KAMs.

- KAMs may include, among other things:
  - Higher assessed risk of material misstatement areas or significant risks;
  - Areas that required considerable auditor judgment, such as accounting estimates; or
  - Significant events or transactions in the current period.

- When engaged to do so, the auditors' report will include a section describing the following for each KAM:
  - Primary reason for designation as a KAM;
  - How the KAM was addressed in the audit; and
  - Refer to the financial statement accounts or disclosures related to the KAM

- If the audit does not identify any KAMs, then the audit report will state that within the conclusion.

- Those who choose not to include KAMs in the auditors' report will continue to receive written and oral communications from their auditor separate from the auditors' report.

- Communication of KAMs does not alter opinion on the financial statements.

STATEMENTS ON AUDITING STANDARDS (SAS) No. 135

- **<u>Effective date: Due to COVID-19, AICPA ASB deferred to 2021 calendar year-end, 2022 fiscal year-end.</u>**

- Intended to enhance the quality of audits by increasing auditors' focus on related parties and transactions with related parties and significant unusual transactions.

- Creates new communication requirements for:
  - Significant unusual transactions;
  - Difficult or contentious matters for which the auditor consulted outside the engagement team; and
  - Uncorrected misstatements that could potentially cause material misstatements on future-period financial statements even though they are considered immaterial to the financial statements under audit.

STATEMENTS ON AUDITING STANDARDS (SAS) No. 136

- **Effective date: Due to COVID-19, AICPA ASB deferred to 2021 calendar year-end, 2022 fiscal year-end.**
- Revises auditors' report on ERISA plan financial statements to provide better insight into the responsibilities of management and the auditor.
- An ERISA limited scope audit is now referred to as an ERISA section 103(a)(3)(C) audit.
- The election to exclude certain investments is no longer considered a scope limitation.
- The auditors' report includes the following changes:
  - A new section regarding the scope and nature of ERISA section 103(a)(3)(C) audits to be presented first, followed by *Opinion* section of auditors' report, followed by *Basis for Opinion* section;
  - Expanded management and auditor responsibility sections; and
  - A two-part opinion addressing information not covered by the investment certification.
- Additional audit procedures are required for an ERISA section 103(a)(3)(C) audit, including:
  - Auditor inquiring of management as to how management determined the entity preparing and certifying the investment information is a qualified institution; and
  - Emphasis that the auditor is required to determine the information that is certified and not certified to conclude which is required to be audited.

NEW LEASE STANDARD (ASC TOPIC 842)

- In February 2016, the FASB issued ASU 2016-02 (ASC Topic 842). ASC Topic 842 supersedes current lease accounting standards under ASC Topic 840. Topic 842 focuses on increasing transparency and comparability to provide financial statement users with more information about an entity's leasing activities and to eliminate "off-balance sheet" accounting.
- **Per ASU 2020-05, non-public entities (including nonprofits) may delay implementation to calendar 2022 year-end, or 2023 fiscal year-end.**
- Early adoption is permitted.
- Comparative statements must be restated using a modified retrospective transition method (defined in a later page).
- A contract is (or contains) a lease when two criteria are met:

  1. The contract explicitly or implicitly specifies the use of an identifiable asset, and

  2. The customer controls the use of the asset for that period of use.
- ASC Topic 842 applies to substantially all leases, but there is still a distinction between operating leases and finance (capital) leases because different recognition and presentation is required on the statements of activities and cash flows.

NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessees

The Transition Approach for Prior Periods Included in the Financial Statements

- Modified retrospective transition approach
  - The cumulative effect of application recognized at either:
    - Beginning of earliest comparative period presented (comparative periods adjusted); or
    - Effective date (comparative periods not adjusted; cumulative-effect adjustment to opening net assets recognized in period of adoption).

- Certain practical expedients are permitted, but must be applied consistently to all leases
  - Package of practical expedients (must be elected together). At the adoption date, an entity may elect not to reassess:
    - Whether expired or existing contracts contain leases under the new definition of a lease,
    - Lease classification for expired or existing leases, and
    - Whether previously capitalized indirect costs would qualify for capitalization under the new standard.
  - Use of hindsight – when determining the lease term and in assessing other lease options.
  - Not to reassess whether land easements not accounted for as leases under current US GAAP qualify as leases under the new standard.

NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessees

Leases on the Statement of Financial Position

- Lessees will recognize all leases, including operating leases, with a term greater than twelve months on the statement of financial position with a right-of-use (ROU) asset and corresponding lease liability.
- This will affect key statement of financial position measures and ratios which could affect compliance with contractual covenants.
- At lease commencement, the lessee will determine if a lease is either a finance lease or an operating lease based on the five criteria:
  - Ownership transfers,
  - Purchase option,
  - Lease term is the major part of the asset's remaining economic life,
  - Present value of lease payments equals or exceeds the fair value of the asset, and
  - Asset has a specialized nature that has no alternative use.

NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessees

Lease Liability Initial and Subsequent Measurement

Lease Liability = Present value of unpaid lease payments

Lease payments exclude variable or contingent payments and must be discounted at the rate implicit in the lease, if available. Lessees may determine a single discount rate for a portfolio of similar type leases. Lessees may also elect an accounting policy to use a risk-free discount rate for all leases or by class of underlying asset, rather than at the entity level.

ROU Asset Initial Measurement

Lease Liability + Initial Direct Costs + Prepaid Lease Payments − Lease Incentives Received

ASC Topic 842 has a narrow definition of initial direct costs and only includes those costs that are directly attributable to obtaining the lease and would not have otherwise been incurred. Some origination costs incurred in negotiating and arranging a lease that are capitalized under current standards will now be expensed, such as fixed employee salaries, cost of advertising leases, and unsuccessful origination efforts.

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NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessees

ROU Asset Subsequent Measurement

Finance Lease

ROU Asset = Beginning Balance − Accumulated Amortization

The ROU asset is amortized on the straight-line basis over the lease term.

Operating Lease

Method 1

ROU Asset = Beginning Balance − Accumulated Amortization

The amortization of the ROU asset each period equals the difference between the straight-line single lease cost for the period and the periodic accretion of the lease liability using the effective interest method.

Method 2

Lease Liability + Unamortized Initial Direct Costs +/− Prepaid (Accrued) Lease Payments − Unamortized Balance of Lease Incentives Received

The carrying amount of the ROU asset is derived from the carrying amount of the lease liability at the end of each reporting period. This is inherently a manual process.

NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessees

Other Key Considerations

- Lease and non-lease components:
  - Non-lease components such as consumables, service costs, and maintenance should be accounted for separately from the lease unless the lessee elects to account for non-lease components as part of the lease to which they relate.

- **Short term leases:**
  - **Lessees may elect not to recognize leases with a lease-term, including optional renewal periods, of twelve months or less as long as they don't include a bargain purchase option.**

- Expanded Qualitative and Quantitative Disclosures:
  - Lease terms and conditions, extension and termination options, purchase options, etc.
  - Operating lease costs, amortization of finance lease ROU assets and interest on finance lease liabilities, variable lease cost, etc.

NEW LEASE STANDARD (ASC TOPIC 842)

Accounting for Lessors

- ASC Topic 842 does not significantly change the way lessors account for leases. Lessors will continue to classify their leases as sales-type, direct financing, and operating leases at lease commencement.
- Changes to how lessors will classify leases. It is expected that fewer leases will qualify as direct financing leases, and lessors will classify the vast majority of leases as sales-type or operating.
- Minor tweaks are made to the accounting for sales-type and direct financing leases, and ASC 842 eliminates the existing special guidelines when accounting for leases involving real estate.

ACCOUNTING FOR NONFINANICAL ASSETS

- **ASU 2020-07, Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets**
  - **Effective date – 2022 calendar year-end and fiscal year-end.** Early adoption permitted.
- **Nonfinancial assets** include fixed assets, use of fixed assets or utilities, materials and supplies, intangible assets, services, and unconditional promises of those assets.
- Present contributed nonfinancial assets as a separate line item in the statement of activities, apart from contributions of cash and other financial assets.
- Disclose in the footnotes:
  - Disaggregation of amount of contributed nonfinancial assets by category.
  - For each category, provide qualitative information about whether the contributed nonfinancial assets were monetized or utilized during the reporting period, and if so, describe the programs or activities in which those assets were used.
  - The nonprofit's policy about monetizing rather than utilizing those assets.
  - A description of donor imposed restricted associated with those assets.
  - A description of the valuation techniques and inputs used to arrive at a fair value measure.
  - The principal market used to arrive at a fair value measure.

ACCOUNTING FOR GOODWILL

- **ASU 2021-03, Intangibles – Goodwill and Other: Accounting Alternative for Evaluating Triggering Events.**
  - **<u>Effective date: 2020 calendar year-end, 2021 fiscal year-end, on a prospective basis.</u>**
  - Provides an accounting alternative that allows private companies and not-for-profit organizations to perform a goodwill triggering event assessment, and any resulting test for goodwill impairment, as of the end of the reporting period, whether the reporting period is an interim or annual period. It eliminates the requirement for companies and organizations that elect this alternative to perform this assessment during the reporting period, limiting it to the reporting date only.
  - The scope of the alternative is limited to goodwill that is tested for impairment in accordance with Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill.

ACCOUNTING FOR GOODWILL

- **ASU 2017-04, Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment**
  - **<u>Effective for 2023 calendar year-end, 2024 fiscal year-end, as per ASU 2019-10.</u>**
  - Eliminates Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.
  - Also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary.

ACCOUNTING FOR CREDIT LOSSES

- **ASU 2016-13, Financial Instruments —Credit Losses: Measurement of Credit Losses on Financial Instruments**
  - **<u>Effective date – for nonprofit entities, extended to 2023 calendar year-end, 2024 fiscal year-end, as per ASU 2019-10.</u>** Early adoption is permitted.
  - Under current GAAP, credit loss recognition is delayed until it is probable a loss been incurred. Expected losses that do not meet the "probable" threshold are therefore not recognized.
  - ASU 2016-13 eliminates the "probable" threshold requirement to recognition and establishes a new impairment model, known as the current expected credit loss ("CECL") model, which requires an entity to reflect its current estimate of all ***expected*** credit losses.
  - Applies to all financial instruments, including trade receivables that result from revenue transactions under ASC 606. Under current GAAP, incurred loss estimates on trade receivables are accumulated within the "allowance for doubtful accounts" contra-asset account. Under the new ASU, this contra-account will instead be called the "allowance for credit losses."

ACCOUNTING FOR CREDIT LOSSES

- **ASU 2016-13, Financial Instruments —Credit Losses: Measurement of Credit Losses on Financial Instruments**
  - Requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts, replacing the previous incurred loss methodology. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates.
  - Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses.
  - Amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

ACCOUNTING FOR CREDIT LOSSES

- **ASU 2016-13, Financial Instruments —Credit Losses: Measurement of Credit Losses on Financial Instruments**
  - Historical loss information generally provides a basis for an entity's assessment of expected credit loss information. Because historical information may not fully reflect an entity's expectations about the future, management should adjust historical loss information, as necessary, to reflect current conditions and reasonable and supportable forecasts. This is a highly judgmental process.
  - Information considered when estimating expected credit losses may include:
    - Borrower's financial condition and/or ability to make scheduled payments;
    - Remaining payment terms of the financial assets and their maturity dates;
    - Nature and volume of financial assets, including volume/severity of past due or adversely classified financial assets;
    - Value of underlying collateral on financial assets;
    - Entity's lending policies and procedures;
    - Experience, ability, and depth of the entity's management, and other relevant staff; and
    - Environmental factors of a borrower and the areas in which the entity's credit is concentrated.

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ACCOUNTING FOR CREDIT LOSSES

- **ASU 2016-13, Financial Instruments —Credit Losses: Measurement of Credit Losses on Financial Instruments**
  - Disclosures required by portfolio segment and major security type of financial instrument include the following:
    - Description of how expected loss estimates are developed;
    - Description of entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of credit losses;
    - Discussion of risk characteristics relevant to each portfolio segment;
    - Discussion of the changes in the factors that influenced management's current estimates;
    - Identification of changes to accounting policies and/or the methodologies from the prior period, a rationale for such changes, and the quantitative impact of such changes;
    - Reasons for significant changes in the amounts of write-offs;
    - Discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period;
    - Amount of any significant purchases of financial assets during each reporting period; and
    - Amount of any significant sales of financial assets or reclassifications during each reporting period.

ACCOUNTING FOR CREDIT LOSSES

- **ASU 2018-19, Codification Improvements Financial Instruments—Credit Losses**
  - **Effective date – same as ASU 2016-13; For nonprofit entities, 2023 calendar year-end, 2024 fiscal year-end.**
  - The guidance clarifies that receivables arising from operating leases are not within the scope of the credit losses standard, but rather, should be accounted for in accordance with the leases standard.
- **ASU 2019-04, Codification Improvements to Financial Instruments—Credit Losses, Derivatives and Hedging, and Financial Instruments**
  - **Effective date - For entities that have not yet adopted the amendments in ASU 2016-13, the effective dates and transition requirements are the same as the effective dates and transition requirements in ASU 2016-13. For entities that have adopted the amendments in ASU 2016-13 as of the issuance date of ASU 2019-04, the effective date is 2020 calendar year-end, 2021 fiscal year-end. Early adoption is permitted as long as the entity has adopted the amendments in ASU 2016-13.**
  - These amendments clarify and improve areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement.

ACCOUNTING FOR CREDIT LOSSES

- **ASU 2019-05, Financial Instruments—Credit Losses: Targeted Transition Relief.**
  - **Effective date – For non-profit entities that have not yet adopted ASU 2016-13, the effective date and transition methodology are the same as in ASU 2016-13, which is 2023 calendar year-end, 2024 fiscal year-end (as per ASU 2019-10). For entities that have adopted ASU No. 2016-13, the amendments are effective for 2020 calendar year-end, 2021 fiscal year-end. Early adoption is permitted.**
  - The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening net asset balance in the statement of financial position as of the date that an entity adopted ASU No. 2016-13.
  - These amendments provide entities that have certain instruments with an option to irrevocably elect the fair value option, applied on an instrument-by-instrument basis for eligible instruments. The fair value option election does not apply to held-to-maturity debt securities.

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ACCOUNTING FOR CREDIT LOSSES

- **ASU 2019-11, Improvements to Topic 326, Financial Instruments—Credit Losses**
- **Effective date – For non-profit entities that have not yet adopted ASU 2016-13, the effective date and transition methodology are the same as in ASU 2016-13, which is 2023 calendar year-end, 2024 fiscal year-end (as per ASU 2019-10). For entities that have adopted ASU No. 2016-13, the amendments are effective for 2020 calendar year-end, 2021 fiscal year-end. Early adoption is permitted.**
  - The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening net asset balance in the statement of financial position as of the date that an entity adopted ASU No. 2016-13.
  - These amendments provide clarified guidance around how to report expected recoveries.
  - "Expected recoveries" describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. This ASU permits organizations to record expected recoveries on purchased credit deteriorated (PCD) assets (assets that have more than insignificant deterioration in credit quality since origination).
  - In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities.

ACCOUNTING FOR DEFINED BENEFIT PLANS

- **ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans**
  - **Effective date – 2022 calendar year-end, 2023 fiscal year-end.** Early adoption is permitted.
  - These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans, including but not limited to the following:

Disclosure Requirements Deleted:

- The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year.
- The amount and timing of plan assets expected to be returned to the employer.
- Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan.

Disclosure Requirements Added:

- The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates.
- An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.
- The amendments also clarify the disclosure requirements related to the following:
  - The projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets.
  - The accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets.