A DEEPER DIVE INTO ASU 2016-14 IMPLEMENTATION ISSUES

By Tammy Ricciardella, CPA

The Fall Nonprofit Standard Newsletter outlined the financial reporting areas for nonprofits that will be impacted by the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*.

As organizations look to implement ASU 2014-16 and meet its requirements, they must account for how these changes may impact how they collect information. This article will highlight three of these areas:

INVESTMENT EXPENSES

As we have noted, the ASU now requires the netting of investment expenses against investment return; in addition, only the net amount of the investment return is required to be presented in the statement of activities. The investment expenses that should be netted against the investment return are both internal and external. To comply with this presentation, organizations need to fully understand the definitions of these terms and then consider how to appropriately and accurately capture this information.

The ASU states that investment returns related to total return investing and not programmatic investing should be reported net of external and direct internal investment expenses. Programmatic investing is defined as "the activity of making loans or other investments that are directed at carrying out a not-for-profit entity's purpose for existence rather than investing in the general production of income or appreciation of an asset." An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.

External investment expenses are those that are reported to the organization by the external money managers and other external investment management firms related to the management of the investment portfolio. This information will be obtained from the external investment firms based on what they have charged.

Direct internal investment expenses are defined in the ASU as those that involve the direct conduct or supervision of the strategic and tactical activities involved in generating investment return. These include, but are not limited to, the following:

- Salaries, benefits, travel and other costs associated with the officer and staff responsible for the development and execution of investment strategy, and
- Allocable costs associated with internal investment management and supervising, selecting, and monitoring of external investment management firms.

Direct internal investment expenses do **not** include items that are not associated with generating investment return. For example, the accounting staff costs associated with reconciling accounts, recording transactions, maintaining the unitization of pooled investment accounts and other such clerical staff time are not direct internal investment expenses, so they would not be included.

Accounting for investment expenses and the related allocation of costs is a process that organizations will have to develop to properly present these investment costs under the provisions of the ASU. The complexity of this will depend on the type of organization and the amount and nature of their investments. For example, the management of a large foundation that handles the strategic aspects of investing their assets internally will have to analyze and establish an allocation methodology for the salaries, benefits and travel related to the total return investing. Entities will need to identify all personnel who participate in the investment process and determine if they have a strategic role or not. In addition, entities may need to develop a process and make modifications to timesheets or other tracking methodologies to capture the time spent aiding the identification and allocation of these costs.

LIQUIDITY AND AVAILABILITY DISCLOSURES

Under the ASU, specific quantitative and qualitative information related to the new liquidity and availability requirements is required to be disclosed. Organizations should assess how they manage their liquid resources to ensure they can meet their

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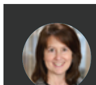
cash needs for general expenditures as of and within one year, respectively, of the statement of financial position date. In addition, organizations will need to evaluate their financial assets to determine their availability to meet cash needs; consider the nature of the assets; examine the external limits imposed by donors, laws, and contracts; and account for any internal limits imposed by governing board decisions. These limitations need to be analyzed and tracked so the organization can identify its available financial assets and provide the necessary disclosures. Other qualitative issues including special borrowing arrangements or instances whereby the entity has not maintained appropriate amounts of cash as required by donor-imposed restrictions and limitations that result from contractual agreements with suppliers, creditors, loan covenants and other sources need to be identified and evaluated to prepare the appropriate disclosures.

INTERNAL NET ASSET DESIGNATIONS

Under ASU 2016-14, the accounting treatment for internally designated net assets hasn't changed; however, the presentation of these amounts and the disclosures have. These changes require entities to properly track these amounts and their related purpose so they can meet the ASU's disclosure requirements.

As we have noted in the past, organizations should review the ASU now and take these items and others into consideration when developing their implementation plan. Though the ASU does not have to be implemented until calendar year 2018 or fiscal year 2019 year ends, preparing for it takes careful planning, so organizations would be well advised to begin the process as soon as possible.



For more information, contact Tammy Ricciardella, director, at tricciardella@bdo.com.

INTERNATIONAL TAX ISSUES IMPACTING NONPROFITS, PART 2: FOREIGN INCOME TAX FOR EMPLOYEES

By Jeffrey Schragg, J.D., CPA; Brad Veltkamp, CPA; Katherine "KC" Reeves, CPA

We provided guidance for nonprofits awarding grants abroad in the first article of our international series in the Fall Nonprofit Standard Newsletter. Now, we turn our attention to nonprofits with employees temporarily working or based on foreign soil.

If your organization employs anyone working outside of their home country, a variety of complex tax issues come into play for those individuals. With individual income tax rates exceeding 50 percent in some nations, it is vital that nonprofit leaders are fully aware of international income taxes that employees may be subject to, so they can educate their employees accordingly.

To aid this process, we've outlined five key international income tax issues to address as one or more of your nonprofit's U.S. employees transition overseas:

1. Identify what obligations your employee may have in the foreign jurisdiction.

Potential obligations to the foreign jurisdiction range from adhering to documentation procedures to tax compliance. Employees may need to obtain the proper work authorization forms to work in their host country. To comply with income taxation in some foreign countries, employees may need to file for and pay the tax themselves. Alternatively, organizations may arrange or be required to pay or deposit the tax on their employees' behalf. Employees may also be required to file a tax return to determine their actual foreign tax liability. In addition, they will need a foreign country return or other adequate documentation to claim a U.S. tax credit for the foreign taxes that they have paid.

2. Determine whether your employee will be subject to, or exempt from, income tax in the host country.

The U.S. has entered income tax treaties with many countries (approximately 75) that may offer exemptions or reduced rates to many U.S. individuals working abroad. But not all treaties function the same—each country has different goals and objectives. As a first step, you and your employees should identify whether the nation they will be based in has established a tax treaty with the U.S. Then familiarize yourselves with its specific terms. Most tax treaties have specific terms for income tax exemption, such as the length of time an individual can spend in the foreign country and/or the amount of money they can earn for services working in the foreign country.

While it is best practice to review each treaty carefully, keeping the length of assignment under 183 days might enable employees to avoid taxation in the host country altogether. For employees exceeding that threshold, the length of the assignment will often have a direct impact on the type and amount of taxation the individual may become subject to. If at the beginning of a foreign assignment, an employee is reasonably expected to work abroad for less than one year, the organization may cover many travel expenses, like housing, cars and per diems, without any additional U.S. income to the U.S. employee. Similar rules allowing for the exclusion of certain company-provided benefits, based on time and intent, typically exist in other countries as well. It is imperative that you engage local tax counsel for in-country tax compliance. Beyond tax treaties, bilateral or status of forces agreements may offer additional exemptions.

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A DEEPER DIVE INTO ASU 2016-14 IMPLEMENTATION ISSUES – PART TWO

By Tammy Ricciardella, CPA

The Winter Nonprofit Standard Newsletter took a more in-depth look at certain changes under Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* and the implementation considerations.

In this issue, we will examine two additional areas of the ASU: Expense reporting and reclassification upon expiration of donor-imposed restrictions.

EXPENSE REPORTING

As we noted in the Fall Nonprofit Standard Newsletter, once ASU 2016-14 is adopted, all nonprofits are required to present expenses by nature and by function, as well as an analysis of these expenses in one location by both nature and function. This analysis can be presented on the face of the statement of activities, as a separate statement (not a supplemental schedule) or in the notes to the financial statements.

As a quick refresher, functional expense classifications are generally shown as:

- **Program services:** Activities that result in goods and services being distributed to beneficiaries, customers or members that fulfill the purposes or mission for which a nonprofit exists
- **Supporting services**, which often include:
  - **Management and general:** Activities generally include oversight of the nonprofit and financial management
  - **Fundraising:** Activities undertaken to induce potential donors to contribute to the organization
  - **Membership development:** Activities undertaken to solicit new members and retain existing members

The ASU has modified the definition of management and general activities. The revised definition is "supporting activities that are not directly identifiable with one or more program, fundraising or membership development activities." Thus, activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities. Additionally, certain costs benefit more than one function and, therefore, should be allocated. For example, information technology generally can be identified as benefiting various functions such as management and general (for example, accounting, financial reporting and human resources), fundraising and programs. Therefore, information technology costs generally would be allocated among functions receiving direct benefit.

The expense analysis required by ASU 2016-14 should show the disaggregated functional expense classifications, such as program services and supporting activities by their natural expense classification, such as salaries, rent, depreciation, interest, professional fees and such.

If there are expenses that are reported by a classification other than their natural classification, such as when a nonprofit shows costs of goods sold and includes salaries in this presentation, these expenses should still be segregated and shown in the analysis by their natural classification within each function.

However, the external and direct internal investment expenses that are netted against investment return (as required by the ASU) should not be included in this analysis of expenses by nature and function.

In addition, gains and losses incurred by the nonprofit on such items as a loss on the sale of equipment or an insurance loss or gain should not be shown in this analysis of expenses.

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It is also important to note that the ASU does not change any current generally accepted accounting principles (GAAP) related to the allocation, reporting and disclosures of joint costs.

The expense analysis presented is required to be supplemented with enhanced disclosures about the allocation methods used to allocate costs among the functions. In developing this disclosure, a nonprofit should assess which activities constitute direct conduct or direct supervision of a program or supporting function, and, therefore require an allocation of costs. An example of a disclosure regarding the allocation of costs is provided below (this is an excerpt from the ASU at section 958-720-55-176):

Note X. Methods Used for Allocation of Expenses from Management and General Activities
The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department and information technology department. Depreciation is allocated based on square footage, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

The revised ASU provides specific examples of direct conduct and supervision as it relates to the determination of certain types of expenses. These are contained at sections 958-720-55-171 through 958-720-55-176 in the ASU. The ASU provides examples of allocations of a chief executive officer, chief financial officer, human resources department and the grant accounting and reporting function. In these sections it notes that the cost of the human resource department is not generally allocated to any specific program, and that instead all costs would remain as a component of management and general activities because benefits administration is a supporting activity of the entire entity.

Nonprofits should review the clarifications in the ASU with regard to the allocation of expenses and review their allocation methodologies to determine if there are any changes that are necessary. Once the organization determines the correct allocation approach, they will need to decide where they want to present this analysis in their financial statements and develop the format. Some organizations may also need to evaluate the different programs and supporting activities they have historically presented to determine if the presentation is concise. In addition, the organization will have to develop the wording for its allocation methodology disclosure.

RECLASSIFICATION UPON EXPIRATION OF DONOR-IMPOSED RESTRICTIONS

If a nonprofit has received funds restricted to the purchase or construction of property, plant or equipment or a donation of such an asset with an explicit donor-imposed restriction on the length of time

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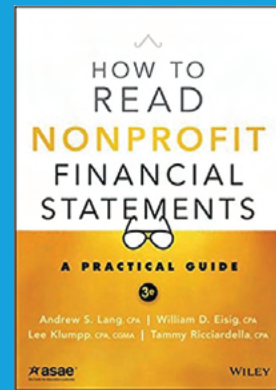

Nonprofit financial reporting practices have been making headlines for the past few months, especially in light of FASB ASU 2016-14, which marked the biggest change to nonprofit reporting standards in decades. The intent behind these changes was to improve the clarity and usefulness of nonprofit financial statements, but those statements can still be tough for even seasoned readers to understand and interpret.

Our own Bill Eisig, Lee Klumpp and Tammy Ricciardella are here to help. They, along with Andrew Lang, President of LangCPA Consulting, co-authored the third edition of How to Read Nonprofit Financial Statements: A Practical Guide, in collaboration with the American Society of Association Executives (ASAE) and John Wiley & Sons, Inc.

The book is designed to be a one-stop resource for anyone who reads, interprets or prepares nonprofit financials statements. This new edition of the book:

- Clearly defines accounting terminology and concepts, while offering numerous examples of financial statements reflecting both the pre-and post-ASU 2016-14 formats
- Steers you, line-by-line, through financial reports, providing explanations of differences between the pre-and post-ASU 2016-14
- Provides numerous illustrations that help you quickly feel at home with the format of nonprofit financial statements
- Offers exercises that help you gain insight into the concepts surrounding nonprofit financial statements and reinforce your command of those concepts

Purchase your copy of How to Read Nonprofit Financial Statements here.

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that the asset must be used, then net assets with donor restrictions should be reclassified as net assets without donor restrictions in the statement of activities as the restriction expires. The amount that is reclassified may or may not be the same as the amount of depreciation recorded on the asset. The amount reclassified each year should be based on the length of time of the explicit time restriction for the use of the asset. However, the depreciation should be based on the useful economic life of the asset.

If the donor does not specify how long the donated assets or assets constructed or acquired with cash restricted for the acquisition or construction must be used, then the restrictions on the long-lived assets, if any, expire when the assets are placed in service.

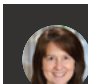
The entire amount of the contribution of property, plant or equipment, or cash shall be reclassified from net assets with donor restrictions to net assets without donor restrictions when the asset is placed in service if there are no explicit restrictions noted by the donor with regard to how long the long-lived asset is to be used.

When examining the effect of the ASU on your organization you should look at whether you have any contributions of long-lived assets that are being reclassified over time without any explicit stipulation of a time period for the use of the asset. If these assets have already been placed in service, the amount of these long-lived assets should be reclassified from net assets with donor restrictions to net assets without donor restrictions upon adoption of the ASU.

In addition, the organization will have to modify its policy with regard to the receipt of contributions for the construction of long-lived assets or donated long-lived assets. Upon adoption of the ASU, an organization will have to recognize revenue without donor restrictions when the donated assets are placed in service absent any explicit donor stipulations otherwise.

In the past, organizations had an option to either follow the placed-in-service approach or to place an implied time restriction on the long-lived assets.

Interested in learning more about changes to nonprofit financial reporting under ASU 2016-14? I recently co-authored a book on the topic with my colleagues from BDO's Institute for Nonprofit Excellence℠ and LangCPA Consulting. The third edition of "How to Read Nonprofit Financial Statements: A Practical Guide" has numerous illustrations and exercises to help readers feel quickly at home with the format of nonprofit financial statements.



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