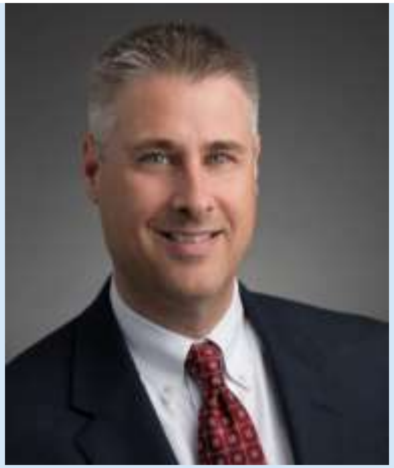
Nonprofit Accounting Update – March 2023

Your instructor



Tom Sneeringer

Partner

RSM US LLP
Gaithersburg, Maryland
+1 301 296 3642
tom.sneeringer@rsmus.com

Agenda

Topic	Minutes
Introductions	5
Considerations Related to Digital Assets (Crypto Assets)	10
ASU 2020-07, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*	5
Revenue Recognition – Still a Challenge	10
Considerations of ASC 842, *Leases*	10
Functional Expense Considerations	5
Summary and Closing Thoughts and Q&A	10

RSM

Objectives

By the end of this presentation, participants will be able to:

- Articulate recent accounting updates and describe their potential effect on nonprofit organizations.
- Discuss the typical accounting issues that may be generated from transactions involving digital assets.
- Discuss the key concepts related to revenue recognition faced by nonprofit organizations.
- Describe the requirements of functional expense reporting of nonprofit organizations.

Considerations Related to Digital Assets (Crypto Assets)

Considerations Related to Digital Assets - A Few Clarifications

- This discussion of digital assets is meant only as a general overview of the typical accounting concepts faced by nonprofits.

- This discussion assumes the nonprofit organization would not be applying specialized industry guidance related to digital assets (such as guidance for Investment Companies) found within US generally accepted accounting principles (GAAP).

- This discussion assumes that the digital assets are directly held by the nonprofit.

- This discussion does not cover potential regulatory or tax issues that may be associated with digital assets.

Accounting and Digital Assets

- There are currently no Financial Accounting Standards Board (FASB) standards that directly address the accounting for digital assets.

- FASB has a project titled *Accounting for and Disclosure of Crypto Assets* on its technical agenda. This project is in the initial deliberations phase.

- Currently, the primary GAAP guidance for the classification and treatment of a digital asset is the Accounting Standards Codification's (ASC's) Subtopic 350-30, Intangibles-Goodwill and Other-General Intangibles Other Than Goodwill.

- The Association of International Certified Professional Accountants' (AICPA's) *Accounting for and auditing of digital assets* Practice Aid and *Blockchain Universal Glossary are* key reference tools.

- Remember that this area is continuing to evolve and change, so be sure to keep an eye out for new developments.

- There are various kinds of digital assets. Today we will be introducing concepts related to the digital assets generally referred to as **crypto assets**.

Definition of Crypto Assets

The AICPA's *Blockchain Universal Glossary* defines a Crypto Asset as follows:

> "A type of digital asset that:
>
> - Function as a medium of exchange and
> - Have all the following characteristics:
>   - They are not issued by a jurisdictional authority (for example, a sovereign government)
>   - They do not give rise to a contract between the holder and another party
>   - They are not considered a security under the Securities Act of 1933 or the Securities Exchange Act of 1934
>
> These characteristics are not all-inclusive, and other facts and circumstances may need to be considered. Examples of crypto assets meeting these characteristics include bitcoin, bitcoin cash, and ether."

Definition of Crypto Assets, continued

- Based on the preceding definition, crypto assets generally do not meet the definition of:
  - Cash
  - Financial Instruments or Financial Assets (including Investments)
  - Inventory

- Therefore, under GAAP, crypto assets are generally considered to be **indefinite-lived intangible assets**. *(Most crypto assets do not have a maturity date, so are considered indefinite in nature.)*

Accounting for Indefinite-Lived Intangible Assets

- Indefinite-lived intangible assets are not subject to amortization. Rather, they are tested for impairment.

- If the impairment test indicates that the carrying value of the intangible asset exceeds the fair value, an impairment loss is recognized.

- In practice, since crypto assets trade constantly, if the quoted value of crypto assets falls below the carrying value **at any point**, it is considered impaired at that moment.

- **Once an impairment loss is recognized, it cannot be reversed even if the fair value recovers in a subsequent period!**

Accounting for Indefinite-Lived Intangible Assets

- Under GAAP, nonprofits record most investments in equity securities and all investments in debt securities at fair value.

- Thus, nonprofits are accustomed to recording net investment gains and losses as investments increase or decrease in value. As values increase or decrease, the investment balance shown on the statement of financial position is adjusted accordingly.

- However, crypto assets are **not** generally considered investments under GAAP. As a result, the accounting can be very different.

Accounting for Indefinite-Lived Intangible Assets

- Cryptocurrencies acquired by a nonprofit would be initially recognized at:
  - Cost, if purchased.
  - Fair value at the date of donation, if contributed.
- Expenses and grants paid using crypto assets are generally recognized using the fair value as of the moment of transfer.

Example Transaction – Receipt of Donated Bitcoin

- On March 10, 2022, the Jolly Foundation receives a donation of 3 bitcoin. At the moment of donation, bitcoin is traded at $25,000.

Entry posted March 10, 2022

Bitcoin	$ 75,000	
Contribution revenue		$ 75,000
To record receipt of donation of 3 bitcoin		

- From March 10, 2022 through March 14, 2022, bitcoin has traded at a value greater than $25,000. However, on March 15, 2022, bitcoin trades at $21,000.

Entry posted March 15, 2022

Impairment loss	$ 12,000	
Bitcoin		$ 12,000
To record impairment loss on 3 bitcoin		

Example Transaction – Payment of Grant with Donated Bitcoin

- On March 16, 2022, bitcoin is trading at $27,000.

  No entry is recorded. The carrying value of the donated bitcoin is not adjusted even though the trading value of bitcoin is now above $21,000.

- On March 17, 2022, the Jolly Foundation issues 2 of the donated bitcoin to the Happiness Fund as a grant to support Happiness's work in spreading smiles throughout society. At the time of the disbursement, bitcoin is trading at $26,000.

Entry posted March 17, 2022

Grant expense	$	52,000		
Bitcoin			$	42,000
Gain on disposition			$	10,000

To record payment of grant using 2 bitcoin

Example Transaction – Sale of Donated Bitcoin

- On March 18, 2022, the Jolly Foundation sells its last remaining bitcoin for $28,000.

Entry posted March 18, 2022				
Cash	$	28,000		
Bitcoin			$	21,000
Gain on disposition			$	7,000
To record sale of one bitcoin				

Concluding Thoughts on Digital Assets and Nonprofit Organizations

- Nonprofits need to understand that holdings in, or conducting transactions with, cryptocurrencies will likely introduce new complexities to their financial reporting and financial statement audit.

- There are a variety of digital assets, and new products are being frequently introduced. The accounting treatment for a digital asset is going to depend on the specific details of the nature of the product or contract.

- Currently, the most common practice we are seeing is for nonprofits to immediately convert donated cryptocurrencies into cash. This reduces the exposure to the unanticipated accounting issues that can accompany cryptocurrencies.

- It is a good idea to be proactive in seeking qualified advice on how to account for digital assets. The correct answer may not be what you initially think!

ASU 2020-07, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*

Effective Date and Transition

- Applicable for annual periods beginning after June 15, 2021, and interim periods within annual periods beginning after June 15, 2022.
- For example, years ended:
  - **June 30, 2022**
  - September 30, 2022
  - December 31, 2022
  - March 31, 2023
- Retrospective application is required.

Reporting of Contributed Nonfinancial Assets

- The Accounting Standards Update (ASU) does not change the accounting for transactions. Rather, it is focused on presentation and disclosure.
- Nonfinancial assets include things such as:
  - Property and equipment
  - Use of property and equipment or utilities
  - Materials and supplies
  - Intangible assets ***(this includes digital assets like cryptocurrency)***
  - <u>*Services*</u>
  - Unconditional promises of these assets

Reporting of Contributed Nonfinancial Assets (Continued)

- Revenue related to nonfinancial assets must be shown as a line item that is separate from contributions of cash or other financial assets.

- The nonprofit is also required to disclose the nature of the contributed nonfinancial assets on a disaggregated basis by category. For example:
  - Digital assets
  - Pharmaceuticals
  - Food
  - Construction labor
  - Media placements
  - Legal services

Reporting of Contributed Nonfinancial Assets (Continued)

Additional required disclosures:

- Qualitative information about whether the contributed nonfinancial assets were either monetized or utilized during the reporting period. If utilized, a nonprofit entity also is required to disclose a description of the programs or other activities in which those assets were used.
- The nonprofit's policy, if any, about monetizing rather than utilizing contributed nonfinancial assets.
- A description of any donor restrictions associated with the contributed nonfinancial assets.

RSM

Reporting of Contributed Nonfinancial Assets (Continued)

Additional required disclosures (continued):

- A description of the valuation techniques and inputs used to arrive at a fair value measure, in accordance with the requirements in Topic 820, “Fair Value Measurement,” of the FASB’s Accounting Standards Codification, at initial recognition.
- The principal market (or most advantageous market) used to arrive at a fair value measure if it is a market in which the recipient nonprofit entity is prohibited by a donor-imposed restriction from selling or using the contributed nonfinancial assets.

Reporting of Contributed Nonfinancial Assets (Continued)

Speaking of contributions …

- ASU 2022-03 could apply to many nonprofits that get donations of equity securities (especially closely held stock)
- The ASU addresses equity securities measured at fair value that are subject to contractual sale restrictions
- The contractual sale restriction is not part of the unit of account and should not impact the recorded fair value amount
- Disclosures
- Perhaps time restricted net asset if the contractual limitation was part of the donation terms

Revenue Recognition – Still a Challenge

Revenue Recognition Challenges

Remember that the revenue recognition principles differ considerably depending on whether an item represents a reciprocal (exchange) or nonreciprocal (contribution) transaction.

- **Exchange Transactions:**

  ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*

- **Conditional versus Unconditional Contributions:**

  ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

Conditional Contributions

- To be **conditional**, a contribution must have ***both***:

  1. A **barrier** that must be overcome **AND**

  2. The donor has a right of return of the assets given or release from their promise to give.

- Remember, you need **BOTH** a barrier **AND** a right of return/release for the contribution to be considered conditional.

Conditional Contributions (Continued)

A **barrier** is something that must be overcome before the nonprofit can be entitled to the contribution.

There are three general indicators that a barrier is present:

- Measurable performance-related barrier.
- Stipulations that limit the recipient’s discretion on the activity’s conduct.
- Stipulations that relate to an agreement’s purpose.

Conditional Contributions (Continued)

Examples of barriers would be:

- Matching requirements *(performance-related barrier)*
- Providing a minimum number of meals *(performance-related barrier and purpose of the agreement barrier)*
- Producing a certain number of donor-approved educational courses *(performance-related barrier and purpose of the agreement barrier)*
- Opening a new care center *(performance-related barrier and purpose of the agreement barrier)*
- Hiring specified people or filling certain staff positions *(limited discretion barrier)*
- Incurring allowable costs to support a program *(limited discretion barrier)*

Conditional Contributions (Continued)

Important points about barriers:

- Routine or trivial stipulations/requirements are not considered a barrier. Requirements to provide financial reports, program achievement reports, or annual reports are generally considered to be routine administrative requirements. They are NOT typically a barrier.

- Whether it is probable or likely that a nonprofit will meet a barrier does not matter. A stated barrier is a barrier, regardless of the likelihood of it being met. The probability exception is now retired.

Conditional Contributions (Continued)

Typical situation

- In October 2022, XYZ Association receives $75,000 from the Lollipop Corporation to sponsor XYZ's Annual Meeting to be held in January 2023. ABC has concluded that meeting sponsorships are contributions (non-exchange transactions). The sponsorship agreement provides for return of funds if the event is not held.

- At December 31, 2022 XYZ should report the $75,000 as a refundable advance (a liability). The contribution is conditioned on the annual meeting taking place (performance barrier). Thus, no revenue should be recognized for the fiscal year ended December 31, 2022 as BOTH a barrier and right of return exists.

Conditional Contributions (Continued)

Important points about rights of return/release from obligations:

- A right of return/release clause by itself does not create a barrier. For example, general "good behavior" clauses and the like typically used by private foundations and corporations do not create a barrier. There needs to be a true barrier in addition to the release clause for the contribution to be conditional.

- In truly ambiguous situations, there is a presumption that the contribution is conditional.

Exchange Transactions

- Terminology is tricky – remember to look at the substance of a transaction to determine the proper revenue accounting:
  - Sponsorship
  - Membership dues
  - Grant
  - Contract

- Bundled revenue arrangements need special attention.
  - May have both contribution and exchange transaction elements
  - Timing of when exchange revenue is earned may be lumpy
  - For UBIT purposes, be mindful of embedded advertising components

Financial Reporting Considerations for Revenue

- Remember that revenue transactions from contributions need to be presented separately from revenue transactions from contracts with customers (i.e., exchange transactions) either on the face of the statements or in the notes to meet the disclosure requirements of ASC 606.

  - Accounts Receivable separated from Promises to Give
  - Deferred Revenue separated from Refundable Advances
  - Revenue from Exchange Activities separated from Revenue from Contributions

Financial Reporting Considerations for Revenue

- Remember that if an organization has revenue from contracts with customers (exchange transactions), the beginning and ending balances of the following need to be disclosed for all financial periods presented:
  - Accounts Receivable and other Contract Assets
  - Deferred Revenue and other Contract Liabilities

- For example, if December 31, 2022 and 2021 financial statements are presented, the organization needs to disclose (probably in the footnotes) the above balances as January 1, 2021.

RSM

Financial Reporting Considerations for Revenue

- Remember that the amount of conditional promises to give as of the end of the reporting period should be disclosed.

- This would include amounts not yet recognized as revenue related to government support that is being accounted for as a contribution.

- This would also include amounts received by the end of the reporting period, but not yet recognized as revenue. In other words, amounts presented as refundable advances would still be included in the total of conditional promises to give at the end of the reporting period.

Considerations of ASC 842, *Leases*

Effective Dates

- If implementation was not already required, the ASU is effective for fiscal years beginning after December 15, 2021.

ASC 842 Big Picture

- Revolutionary change in lease accounting.
- Impacts all companies/organizations with leases in all industries.
- Most leases will be recorded on balance sheet, similar to capital leases under ASC 840.
- Leases will be classified as either operating leases or finance leases for statement of activities purposes.
- Changes to the balance sheet will impact financial ratios.
- Nonprofits should consider if a lease includes elements of a contribution.

RSM

Discount Rate Considerations ***(Updated Guidance from Last Year)***

- The method used by lessees to select the appropriate discount rate for lease liability calculations has been updated by the FASB via the issuance of ASU 2021-09 in November 2021.
- The rate implicit in the lease will be used ***whenever*** the rate is readily determinable. (Even if the risk-free rate election has been made.)
- Lessees that are not public business entities (which would be all nonprofits) can elect to use the risk-free rate instead of their incremental borrowing rate. This election would be made by class of underlying asset.
- The lessee's incremental borrowing rate for collateralized debt is to be used in cases where the implicit rate is not readily determinable and the risk-free rate election has not been made.
- This new methodology is effective upon an entity's adoption of ASC 842. Or, if ASC 842 has already been adopted, effective for years beginning after December 15, 2021. Early adoption is permitted.

RSM

Preparing Journal Entries under ASC 842 – Tips and Tricks

- Lease amortization software is very helpful. But, loan software may work as well. Input the key data and then solve for the opening 'loan' balance. This will essentially be your initial lease liability. Consider hiring a consultant to help with the calculation.
- For operating-type leases, lease expense is still recognized on a straight-line basis over the lease term.
- The change in the right-of-use (ROU) asset is essentially a balancing entry.   It will generally NOT amortize on a straight-line basis.
- Assets acquired via tenant improvement allowances and incentives are accounted for and presented separately from the ROU asset.
- Upon implementation of ASC 842, the existing 'deferred rent' liability will be removed and be incorporated into the 'lease liability' balance.

Transition methods

Two options:

- Modified retrospective beginning of earliest comparative period presented.
- Alternative modified retrospective beginning of the reporting period in which ASC 842 is first applied. (Essentially shows a one-time implementation adjustment at the start of the current year. Prior period financial statements are not adjusted.)

Functional Expense Considerations

Functional Expense Considerations

- Nonprofits are required to present expenses reported by their functional as well as natural classification. (Either on the face of the statements or in the footnotes.)

- This naturally requires allocations of costs between program services and supporting activities.

Functional Expense Considerations (Continued)

- Nonprofits should periodically consider their cost allocation methodologies. Do they fairly allocate costs to all program and supporting activities that benefit from them?

- Not appropriately allocating costs can cause a departure from GAAP.

- ASC 958-720-45 provides very readable guidance on how costs should be classified and allocated.

Functional Expense Considerations (Continued)

- A fundraising activity that contains components of other functions, such as program or administrative, is termed a **joint cost**.
- Joint costs are presumed to be 100% fundraising. But, if all of the following three tests are met, costs can be allocated to the program or administrative functions benefited.
  - Purpose
  - Audience
  - Content
- ASC 958-720-45-29 contains the detailed guidance on the considerations regarding joint cost accounting. This can be a very challenging area.

Bonus area!

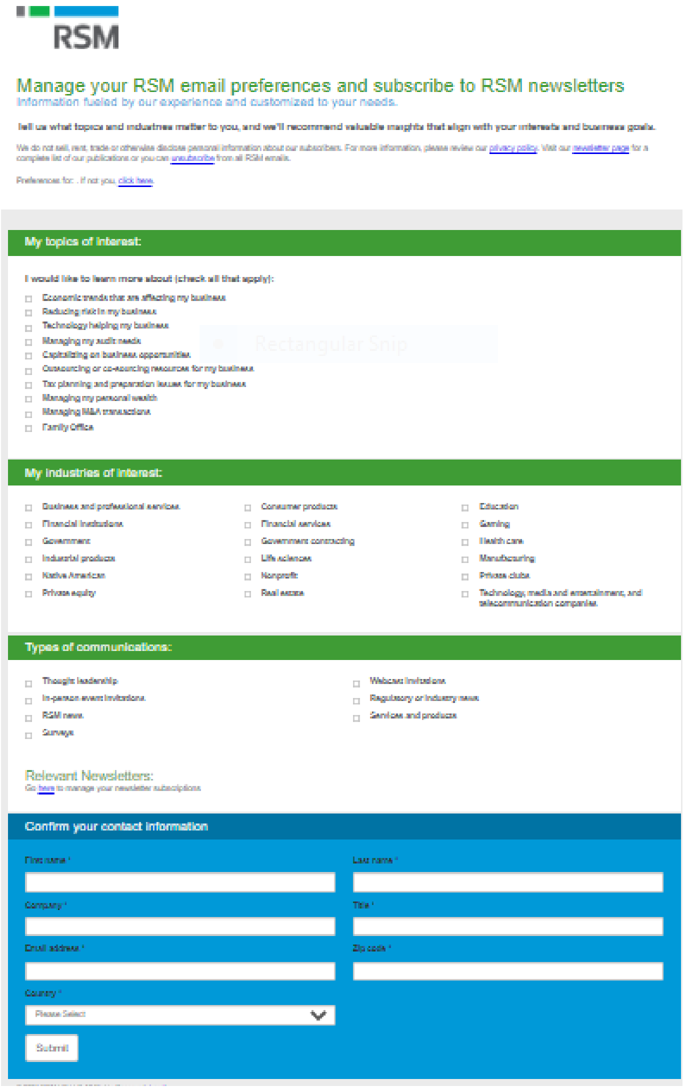
Tom's Oldies but Goodies (Reminders)

- Items that might be missing (completeness aspects) from the financial statements:
  - Split-interest agreements including beneficial interests in trusts
  - Bequests (that have been through probate)
  - Long-term gifts of use of facilities
  - Consolidation with other nonprofits
  - Financially-interrelated nonprofits
  - Old fashioned promises to give (pledges)

Additional Resources

- Visit RSM’s [email and subscriptions preference center] in order to subscribe to our newsletters and other thought leadership.

- The **Muse** newsletter is a must-read for nonprofit professionals!



QUESTIONS AND ANSWERS

THANK YOU FOR YOUR TIME AND ATTENTION

RSM US LLP

One South Wacker Drive, Suite 800
Chicago, IL 60606
312.634.3400

+00 (1) 800 274 3978
www.rsmus.com