Health Care Accounting Update

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Agenda

- New Revenue Recognition Standard (ASU 2014-09)
- Changing Reimbursement Models and the Effect on Accounting
- Changes to Lease Accounting (Proposed ASU)
- Private Company Council (GAAP alternatives for privately held companies)
- Discontinued Operations (ASU-2014-08)
- Going Concern (ASU-2014-15)
- FASB Exposure Draft, *Presentation of Financial Statements of Not-for Profit Entities*

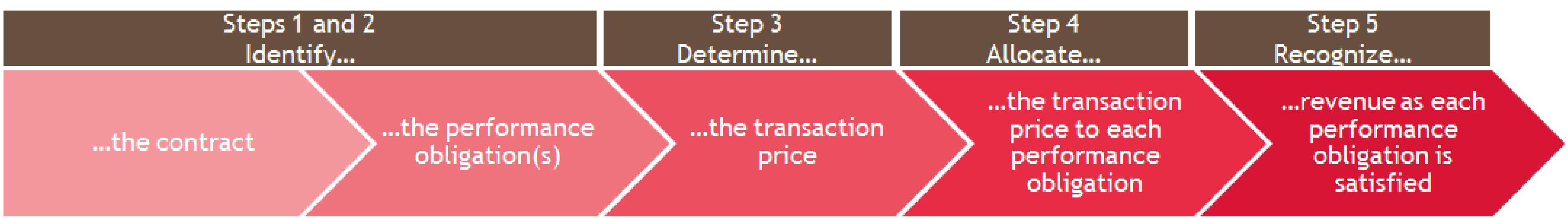
New Revenue Recognition Standard

ASU 2014-09: Summary of New Revenue Recognition Standard

Core principle:

Recognize revenue to depict the transfer of 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 five steps to apply the core principle are:



Effective Date

- Public business entities effective for annual reporting periods beginning after December 15, 2017, including interim periods within that year. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.
- All other entities effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted as of either:
  - An annual reporting period beginning after December 15, 2016, including interim periods within that year, or
  - An annual reporting period beginning after December 15, 2016 and interim periods within annual reporting periods beginning one year after the annual period in which an entity first applies the new standard.

AICPA Revenue Recognition Industry Task Forces

- The AICPA has formed sixteen industry task forces to help develop a new Accounting Guide on Revenue Recognition that will provide illustrative examples for how to apply the new Revenue Recognition Standard
- Health Care is one of the identified industries

ASC 606 Issues Impacting the Health Care Industry

The AICPA health care task force has identified the following potential implementation issues for the health care industry:

1. Consideration of the following regarding self-pay balances:
   - Application of Step 1 in determining if there is a contract
   - Application of Step 3 in determining the transaction price considering allowances/discounts and implicit price concessions
   - Application of the portfolio approach to contracts with patients

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ASC 606 Issues Impacting the Health Care Industry (continued)

2. Continuing Care Retirement Communities ("CCRC") Revenue Stream:

- Identifying and satisfying the performance obligation(s) and recognizing the monthly/periodic fees and nonrefundable entrance fees under Type A or "life care" contracts for continuing care retirement communities
- Identifying the performance obligation(s) and recognizing the performance obligation(s) to provide future services and use of facilities
- Significant Financing Component - CCRC Contracts

ASC 606 Issues Impacting the Health Care Industry (continued)

3. Disclosure requirements for health care entities
4. Accounting for contract costs
5. Determination (estimation) of transaction price (expected value vs. most likely) as it relates to third party estimates

Source:

www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rrtf-healthcare.aspx

Disclosure Requirements

Qualitative and quantitative disclosures include:

- The entity's contracts with customers
  - Disaggregation of revenue
  - Information about an entity's contract assets and contract liabilities (including reconciliations)
  - Information about the entity's performance obligations
  - The entity's remaining performance obligations at the end of the reporting period
- Significant judgments in the application of the guidance
  - Determining the timing of satisfaction of performance obligations
  - Determining the transaction price and amounts allocated to performance obligations
- Assets recognized from the costs to obtain or fulfill a contract with a customer
- Use of practical expedients

Implementation and Other Considerations

- Early preparation is key to a smooth transition
  - Accounting and reporting
  - Tax
  - Business processes and systems
  - Change management and communication

- Significant judgments and estimates involved in ASC 606

- Communicate with key stakeholders and audit committee

Changing Reimbursement Models

Early Evidence of the Shift to Value

- Hospital Quality Reporting (inpatient and outpatient)
- EHR Incentive Program
- Readmission Reduction Program
- Value Based Purchasing
- Center for Medicare and Medicaid Innovation
- Medicare Shared Savings Programs
- Accountable Care Organizations
- Value Payment Modifier
- Hospital Acquired Infection Penalties

Medicare Shifting to a Focus on Value

Goal is to have 50% of all Medicare payments and 90% of fee for service Medicare tied to value by 2018

- Develop and test new payment models
- Encourage greater integration, coordination among providers, and attention to population health
- Accelerate availability of EHR information and interoperability
  - ACA established Patient-Centered Outcomes Research Institute with goals of research findings being disseminated through EHRs
- Medicare website allows consumers to compare data on costs and quality

Burwell S. Setting value based payment goals…NEJM. January 26, 2015.
Japsen B. White House plans to shift Medicare…Forbes. January 26, 2015.

Commercial Payers Also Shifting to a Focus on Value

- United Health
  - Initiated value based contracting in 2012
  - Claims it has saved 1 – 6% be value based initiatives
  - Plans to increase value based payments to doctors and hospitals by 20% in 2015 to $43 Billion and to $65 Billion by 2018
- Aetna
  - Claims 8 – 15% savings first year in transition to ACO model and $1,600 per member over 3 years
  - Predicts increased value based spend to triple from 2013 - 2017
- Humana
  - Claims full accountability (per member per month of payment) reduces Medicare costs by 22% compared with no provider incentives

Japsen B. United Health's $43B exit…Forbes. January 23, 2015
Funk M. Humana's approach to value based reimbursement. January 24, 2014.
2013 Aetna Investor Conference. December 12, 2013.

Accounting Implications and Risks of Changing Reimbursement Models

Guidance under ASC 954-605, *Health Care Entities, Revenue Recognition*, does not address revenue that is not directly derived from "fees charged for patient care".

It is unclear whether this guidance was intended to apply to risk contracts.

- Risk pools
- Pay-for-performance and shared savings/loss arrangements

Accounting Implications and Risks of Risk Pool Contracts

Risk pool contracts typically provide a mechanism for sharing favorable and unfavorable financial results among providers. Participants in the arrangement will share in the overall profits or losses of the contract.

- Final settlement is generally at the end of the contract term
- Complexities can include settlements dependent upon various factors such as:
  - Utilization levels
  - Actual costs incurred
  - Risk adjustment factors
  - Amounts available in the risk pool

Accounting Implications and Risks of Risk Pool Contracts

- For straightforward risk pools where the contract term and the provider's fiscal period the same, consideration is if actual settlement should be recorded in the corresponding fiscal period.
- If the periods are different, consideration should be given to if an estimate can be made using year to date experience.
- If actual settlement is unknown due to other complexities in the calculation, the provider should consider using a combination of year to date and historical experience and other relevant data in order to develop an estimate.
- Consideration should be made in regards to collectability of settlement receivables (i.e. the other part's ability and/or intent to pay).

Accounting Implications and Risks of Risk Pool Contracts

- Consideration as to whether subsequent adjustments to estimates based on actual settlements or other updated information should be treated as a change in estimate and recorded in the period those amounts become known
- ASC 944-605, *Financial Services, Revenue Recognition*
  - Premiums that are subject to adjustment should be recognized as follows:
    - If the ultimate premium is reasonable estimable, the estimated ultimate premium should be recognized over the period of the contract
    - If the ultimate premium cannot be reasonably estimated, the cost recovery or deposit method may be used until the ultimate premium becomes reasonably estimable

Accounting Implications and Risks of Pay-for-Performance and Shared Savings/Loss Arrangements

Scope of the healthcare subtopic of the ASC 605, *Revenue Recognition*, includes:

- Patient service revenue for fees charged for patient care through fee for service arrangements
- Premium revenue derived from capitation arrangements
- Resident service revenue

Does not address pay-for-performance or shared savings/loss arrangements.

Accounting Implications and Risks of Pay-for-Performance and Shared Savings/Loss Arrangements

Need to consider other, more general guidance, i.e. the four criteria for revenue recognition:

- Persuasive evidence of an arrangement
- Delivery has occurred or services have been rendered
- Fixed or determinable selling price
- Collectability is reasonably assured

All four criteria must be met before revenue recognition can occur.

Accounting Implications and Risks of Pay-for-Performance and Shared Savings/Loss Arrangements

Persuasive evidence of arrangement

- Documents all terms and conditions agreed to by the customer and vendor
- Generally an agreement exists with these arrangements and this criterion is met

Delivery of product or rendering of service

- When is the revenue "earned"?
  - When the entity has substantially completed what it must do to be entitled to the revenue. i.e., when the entity has satisfied substantially all of its obligations
- In most of these arrangements, the ultimate amount may be dependent on a variety of factors that may not be known until the end of the contract term; however, consideration should be whether an estimate can be made using year to date and other applicable, historical data.

Accounting Implications and Risks of Pay-for-Performance and Shared Savings/Loss Arrangements

Fixed or determinable selling price

- Total consideration needs to be known or estimable with reasonable certainty
- Similar to delivery of product or rendering of service before, consider whether estimates can be made using year to date and other historical data
- Availability and accuracy of data is critical
  - While historical experience is helpful, current conditions and factors need to be considered in conjunction with that historical experience
  - Providers should perform **retrospective reviews** of estimates to determine how accurate both the data and methodology for estimation is.

Collectability is reasonably assured

- Does the other party have the ability/intent to pay?
- Should be evaluated at outset of arrangement

Other Accounting Considerations

Risk Pool versus Shared Savings/Loss Contract

- Arrangements are similar in the sense that both provide for sharing of risks and rewards among the parties
- Distinguishing factor
  - Risk pool – provider's only compensation for services is from distributions form the pool
  - Shared savings/loss – provider generally receives fee-for-service payments in addition to financial incentives or penalties
- Consideration should be given as to the type of arrangement as revenue recognition could be different

Other Accounting Considerations

Loss Contracts

- Sometimes providers will incur a loss on the contract
- Losses should be accrued when it is probable that the contract will result in a loss and that loss can be reasonably estimated
- Gains cannot be recorded until realized

Stop-loss Insurance

- Premiums should be recorded as health care costs (operating expense)
- Recoveries should be recorded as a reduction of health care costs
- Stop loss insurance receivables are recorded as an asset (along with any valuation allowance) and accrued health claim liabilities are reported gross of insurance receivables

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Other Accounting Considerations

Financial Reporting and Disclosures

- The following should be considered for disclosure in the notes to the financial statements:
  - Nature and term of significant risk contract arrangements
  - Revenue recognition policies and methods
  - Whether the entity has recorded any revenues that are at risk for future contingencies and adjustment, the nature of such contracts and the amount of any such revenue recorded (if material)
  - Basis for recording expenses and losses under the contract
  - Significant stop-loss insurance contracts
  - If the contract involves a related party, the necessary related party disclosures under ASC 850, *Related Party Disclosures*

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Lease Accounting

Lease Exposure Draft Summary (TOPIC 842)

- Re-released on 5/13/2013; comment period ended 9/13/2013
- Dual approach for both lessees and lessors
- Consumption-based model
- For most property leases, lessee would report a single, straight-line lease expense for its use of underlying asset
- For most other leases (e.g., equipment or vehicles), lessee would report asset amortization separately from interest on the lease liability
  - Results in "front-loading" expense recognition in early years of the lease

Scope and Effective Date

- Applies to all leases, *except* leases of intangible assets, leases for exploration or use of certain natural resources and leases of biological assets

- Final standard expected in later half of 2015.

- Would apply to all leases existing at “the beginning of the first comparative period” present upon adoption. Thus, *no grandfathering* of existing leases except for leveraged leases!

Identifying a lease

Lease

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

Determine at inception based upon:

- Whether contract fulfillment depends on use of an *identified asset**
- Whether contract conveys right to control use of identified asset for consideration for a time period

* Consider whether supplier has *substantive right of substitution*

What is a lease: Control of use
Medical treatment

Customer signs a 3 year contract for medical equipment

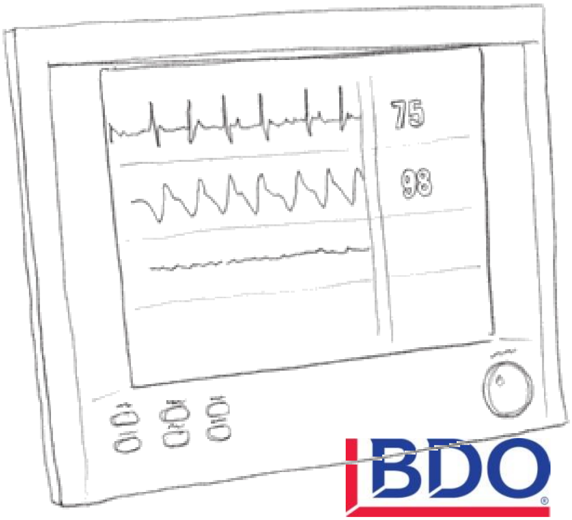
Supplier installs equipment on Customer's premises

Customer must purchase consumables from Supplier that connect the patient to the equipment

Consumables are readily available from other suppliers

Customer operates the equipment and determines how and when the equipment is used

Does this arrangement contain a lease?



What is a lease: Control of use

The arrangement contains a lease.

Although the contract requires Customer to purchase the consumables from Supplier, consumables that function with the monitoring equipment are readily available from other suppliers.

- Customer can derive the benefits from use of the monitoring equipment without Supplier's consumables

Lease Classification

Both lessees and lessors must evaluate <u>at commencement</u> of lease:

Type A

- Most leases *<u>other than property</u>* (e.g., equipment, aircraft, cars, trucks)
- A non-property lease is considered Type A <u>unless</u> lease term is:
  - for an insignificant part of the total economic life of the underlying asset OR
  - Present value of the lease payments is insignificant relative to the FV of the underlying asset at commencement.
- If either of the above considerations are met, the lease is Type B

Type B

- Consist of *<u>most property leases</u>* (e.g., land and/or building or part of a building)
- A property lease is considered Type B unless :
  - lease term is for the major part of the remaining economic life of the underlying asset OR
  - present value of the lease payments accounts for substantially all of the FV of underlying asset at commencement
- If either of the above conditions is met, the lease is Type A

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Lessee Accounting

Initial measurement	**Right-of-use asset** • Present value (PV) of lease payments + lessee's initial direct costs • Initial direct costs: Incremental costs directly attributable to negotiating and arranging a lease • Recognize lease incentives as a reduction in the right-of-use asset **Lease liability** • PV of lease payments
Subsequent measurement	**Right-of-use asset** • Amortized cost: Method of amortization depends on nature of underlying asset (i.e., Type A or Type B) • Impairment: Refer to existing standards (ASC 360) **Lease liability** • Amortized cost: Use the effective interest method

Lease term and rentals

Two elements form basis for PV of lease payments:

Lease Term

- Estimated as the non-cancellable period of the lease
- Include periods under option to extend IF lessee has *significant economic incentive to exercise* option
- Include periods under option to terminate IF lessee has *significant economic incentive NOT to exercise* option

Rentals

- Fixed lease payments (less incentives to be paid by lessor)
- Contingent rentals tied to an index
- Contingent rentals which are in-substance fixed payments
- Residual value guarantees
- Exercise price of purchase option IF lessee has *significant economic incentive to exercise* option
- Termination penalties IF lease term reflects lessee exercising option

Lessee Accounting

Presentation for LESSEES:

Balance Sheet

All leases:

Either present separately* or combine with appropriate class of assets and liabilities with proper disclosure

*No co-mingling of Type A and Type B leases

The above presentation was reaffirmed at the June 2014 meeting

Income Statement

- *Type A:* Display interest on lease liability ***separately from*** amortization of ROU asset
- *Type B:* Display interest on lease liability ***together with*** amortization of ROU asset

Lessee Accounting

Presentation for LESSEES:

Statement of Cash Flows *

- Operating activities
  - Interest on lease liability arising from Type A leases
  - Payments arising from Type B leases
  - Variable lease payments and S/T lease payments not included in lease liability
- Financing activities
  - Principal repayments on Type A leases

* Reaffirmed at the June 2014 meeting

Lessor Accounting

Two models - Type A (receivable & residual model) is set out below.

Initial measurement	**Lease receivable** • Present value (PV) of lease payments discounted at the rate lessor charges the lessee plus any initial direct costs (except that initial direct costs are immediately expensed if there is selling profit) **Residual asset** • PV of estimated residual value at end of lease term discounted at rate lessor charges lessee - Do not include amounts expected to be received under residual value guarantee (RVG) until end of lease • Present gross residual asset and deferred profit as net residual asset **Selling Profit** • Recognize pro rata profit or loss, if any
Subsequent measurement	**Lease receivable** • Amortized cost: Effective interest method - Impairment: refer to ASC 310 guidance • Recognize in net income changes due to reassessment of variable lease payments that depend on index or rate **Residual asset** • Accrete to estimated residual value at end of lease term -Do not recognize deferred profit until residual asset is sold/re-leased - Impairment: refer to ASC 360 guidance (consider any RVG)

Lessor Accounting

Two models - Type B (operating lease accounting) is set out below.

Initial measurement	**Underlying asset** • Continue to recognize underlying asset **Initial direct costs** • Expensed over the lease term on the same basis as lease income
Subsequent measurement	**Underlying asset** • Impairment: refer to ASC 360 guidance **Lease Income** • Recognized on a straight line basis unless another systematic basis is more representative

Lessor accounting - Sales-Type Leases (Existing GAAP)

- Result in either manufacturer's/dealer's profit or lessor's loss
  - FV of leased property at inception does not equal carrying amount
- Normally used as a means for marketing products

Example: Lessor manufactures and leases to Lessee equipment with FV of $80K and cost of $60K. Lease term 10 years, equipment useful life 12 years. Lessee to pay 10 annual payments of $10K. Estimated residual value at end of lease term is $5K.

Lessor accounting - Direct Financing Leases (Existing GAAP)

- No resulting manufacturer's/dealer's profit or lessor's loss
- Normally used as a means for financing the acquisition of property by lessee

Example: Lessor manufactures and leases to Lessee equipment with FV ***and*** cost of $60K. Lease term 10 years, equipment useful life 12 years. Lessee to pay 10 annual payments of $8K. Estimated residual value at end of lease term is $5K.

Other Provisions

- **S/T Leases:** At inception, both lessees and lessors could elect NOT to recognize assets or liabilities, NOR to derecognize a portion of the leased asset and simply recognize lease activity in earnings over the lease term
- **Sale-Leasebacks:** A transferor would assess whether transferred asset has been sold using the "control principle" (outlined in the New Revenue Recognition standard) and account for transactions as either sales or financings
- **Subleases:** Classify as Type A or Type B with reference to underlying asset (vs. right-of-use asset for IFRS) – In the June 2014 meeting the boards decided that:
  - if the primary lease and the sublease are entered into at the same time, the intermediate lessor would be required to assess combining these contracts
  - the intermediate lessor can only offset assets and liabilities if existing offsetting requirements in ASC 210-20 are met

Other Provisions

- **Separate Components:** Lessees and lessors would both be required to separately account for lease and non-lease components
  - ED provides separation and allocation guidance for lessees; lessors would apply allocation guidance in the new Revenue Recognition standard
  - In May 2014, the boards agreed on a practical expedient – lessees have the option of an accounting policy election to account for lease and non-lease components as a single lease component
- **Related Party Leases:** Account for it based on legally enforceable terms and conditions – no longer required to evaluate economic substance

Disclosures

- Contractual details (lease term, contingent rentals, options, etc.) and related accounting judgments
- Maturity analyses of undiscounted lease payments
- Reconciliations of amounts recognized in the statement of financial position
  - Lessees: rollforwards of lease liabilities by class of underlying asset
  - Lessors: reconciliations of right to receive lease payments and residual assets
- Narrative disclosures about leases (including information about variable lease payments and options)

Transition considerations

Developing a plan to transition, including impacts on:

- ICFR
- Planning and budgeting
- Taxes
- Compensation arrangements
- Debt covenants and other contracts
- Internal and external communication

Private Company Council

GAAP alternatives for privately held companies

Private Company Council Background and Purpose

- Established by Financial Accounting Foundation (FAF) in May 2012

- Two-fold purpose:
    1. To determine whether exceptions or modifications to existing standards are necessary to meet the needs of private company financial statement users
        - E.g., accounting for goodwill; hedge accounting
    2. To serve in an advisory capacity to the FASB
        - E.g., development stage entities proposal

- FASB & PCC issued *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (December 2013)
    - Guide for determining whether and when to provide alternative guidance

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Private Company Council

Key initial issues:

- Areas with complexity that do not have same level of impact on private companies
- Areas of higher costs vs. benefit for private companies
- Consideration of users of financial statements and access to management

ASUs issued to date:

- ASU 2013-12: Definition of a Nonpublic Entity
- ASU 2014-02: Goodwill
- ASU 2014-03: Interest Rate Swaps
- ASU 2014-07: Common Control Leasing and VIE
- ASU 2014-18: Intangible Assets in a Business Combination

ASU 2013-12: Definition of a Nonpublic Entity

US GAAP currently contains 5 definitions of a nonpublic entity, 3 definitions of a public entity and 2 definitions of a publicly traded company.

- ASU 2013-12, *Definition of a Public Business Entity: An Addition to the Master Glossary* provides an definitive definition for future projects, but did not amend existing definitions
- PCC in discussions about definitive definition for all GAAP and clarify types of entities that could be considered a public business entity (PBE).
- Some of the current definitions could include NFP or employee benefit plans

ASU 2014-02: Goodwill

PCC Alternative

- Allows amortization of goodwill
- Life is 10 years unless company supports less than 10 years
- Policy election to test goodwill at entity level or reporting unit level for triggered impairment testing
- No annual impairment test required
- If impairment indicators one step test – carrying value over fair value (no two-step allocation)
- Optional qualitative assessment

ASU 2014-03: Interest Rate Swaps

Derivatives and Hedging – Accounting for certain receive-variable pay-fixed interest rate swaps – simplified hedge accounting approach

- Intended for those instruments which economically change the character of debt from variable rate to fixed rate
- Interest expense approximates fixed rate debt
- Can assume no ineffectiveness
- Must meet specific criteria (generally basic swaps)
- Documentation required for hedge accounting may be completed anytime prior to the issuance date of the financial statements.
- Can measure at settlement value or fair value

ASU 2014-07: Common Control Leasing and VIE

Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements

- Many entities need to consolidate VIEs due to leasing arrangements
- Provides <u>exemption</u> from consolidation
- Arrangement:
  - Lessor entity and private company lessee are under common control
  - Private company enters into leasing arrangement with lessor (often tax motivated)
  - Substantially all activity between two entities is related to leasing activity
  - If private company lessee guarantees or provides collateral for obligation of lessor related to leased asset the principal at inception does not exceed value of asset

Asu no. 2014-18: Accounting for identifiable intangible assets in a business combination

- Option to allow private companies not to separately recognize and measure non-competition agreements and customer-related intangible assets that are not capable of being sold or licensed independently in a business combination.
  - If elected, only applies to intangible assets arising from transactions after adoption. That is, existing intangible assets are not affected.
  - If elected, also requires adoption of ASU 2014-02, *Accounting for Goodwill* regarding amortization and impairment.

- Examples of customer-related intangible assets that may still need to be recognized: mortgage servicing rights, commodity supply contracts, core deposits and customer lists.

- Generally effective for new transactions in years beginning after 12/15/15, with early adoption permitted.

- BDO Flash Report to be issued soon.

PCC Potential Agenda Projects

- Other topics:
  - Partnership accounting
  - Stock-based compensation – potential simplification to fair value measurement
  - Other comprehensive income – potential option to record certain items in net income, rather than OCI.
  - Conforming existing definitions of public/private entities to ASU 2013-12.
  - Debt/equity issues – explore certain simplifications to specific areas of existing US GAAP.
  - Accounting for uncertain tax positions (as referenced in ASC Topic 740, formerly FIN 48) – continuing outreach.

Discontinued Operations and Going Concern

ASU 2014-8: Discontinued Operations (Topics 205 & 360)

- Changes the criteria for reporting discontinued operations
  - Changes the definition so that only **major** strategic shifts are reported in discontinued operations
  - Qualitative assessment has to be made to determine whether there is "strategic shift" – there is no definition of this term or bright line guidance
  - Examples of a strategic shift could include a disposal of a major geographical area, line of business, equity method investment
  - Revised definition also includes a business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale
- Eliminates extensive continuing involvement test that existed in GAAP
- Does not change the definition of "held-for-sale"

ASU 2014-8: Discontinued Operations (Topics 205 & 360)

- Significant amount of new disclosures, including disposals that don't qualify as major
- Prior period assets and liabilities of a disposal group that qualifies as discontinued operations must be reclassified – cannot offset assets and liabilities into a single amount – applies even when discontinued operations are disposed of by sale before meeting held-for-sale criteria
- Impairment losses from remeasuring assets held-for-sale should not be allocated to individual assets – present the impairment in total
- Applies prospectively for all entities for annual periods beginning after 12/15/2014 and interim application for public companies in 2015 and for others in 2016
- No retrospective application for components already classified as held-for-sale on the adoption date

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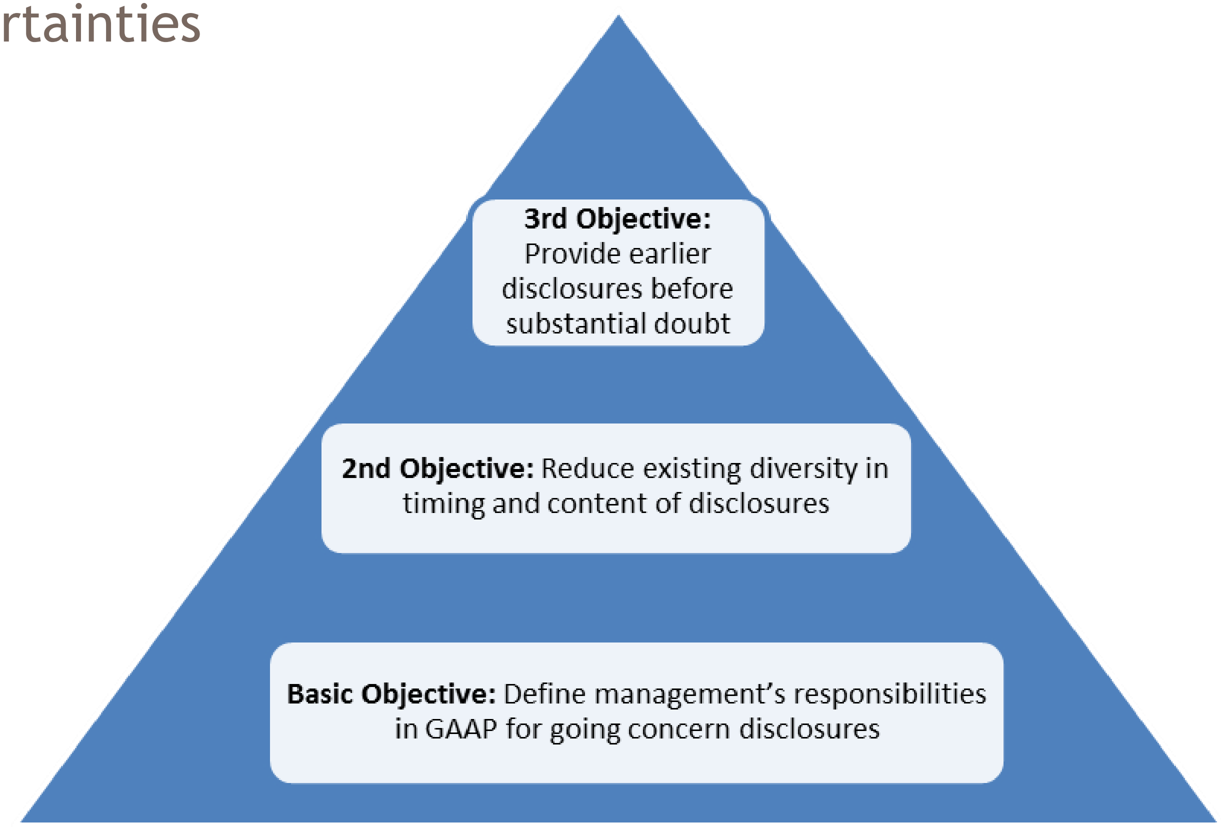
ASU 2014-15: Going Concern (Subtopic 205-40)

- U.S. GAAP previously had no guidance on management's disclosures of GC uncertainties; auditors are responsible for assessing GC uncertainties



ASU 2014-15: Going Concern (Subtopic 205-40)

- Requires management to determine whether substantial doubt exists regarding the entity's going concern presumption
- Substantial Doubt - definition incorporates a probability threshold (as used in Topic 450 on contingencies)
- Assessment Period - one year from the date the financial statements are issued or available-for-issuance (not the balance sheet date) at each annual and interim period
- Disclosures
    - In periods when substantial doubts exist
    - When substantial doubt is alleviated by management's plans

Flash Report: http://www.bdo.com/download/3405

FASB Exposure Draft, *Presentation of Financial Statements of Not-for Profit Entities*

Key Elements of the Proposal

- Net asset classes
- Activity statement and operating measures
- Cash flow statement

Net Asset Classes

- Proposal to replace current three classes in the current requirement with two classes

Current GAAP	Unrestricted	Temp. Restricted	Perm. Restricted
Proposed GAAP	Without Donor Restrictions	With Donor Restrictions	
+			
Disclosures	Amount, purpose, and type of board designations *	Nature and amount of donor restrictions	

* New disclosure requirement

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Activity Statement and Operating Measures

- Similar to net assets, proposed ASU requires presentation of changes to each of the two classes of net assets, as well as the total change
- Proposes to require presentation of two measures of operating activities
  - First operating subtotal is that of operating revenues, support, operating expenses, and operating gains and losses that excludes amounts that are unavailable due to donor restrictions
    - This subtotal should reflect amounts that are available to and used for carrying out the organization's purpose of existence
    - Disregards how organization finances its operations as debt and investing activities would be presented outside of the operating measure
  - Second operating subtotal is that of the first subtotal plus or minus the impact of operating transfers
- Proposal presents investment income/loss and interest expense separately from the operating measures

Activity Statement and Operating Measures

Statement of activities

	Without Donor Restrictions		With Donor Restrictions	Total
Revenue and support:				
Fees for services	$ 495			$ 495
Bequests	600			600
Other contributions	425		1,500	1,925
Restricted support released	1,375		(1,375)	-
Total revenue and support	2,895			
Expenses:				
Total expenses	1,950			1,950
Operating excess before transfers	945			
Transfers to/(from) operating activities:				
Aggregate of transfers to operating activities	150	a		150
Aggregate of transfers from operating activities	(500)	b		(500)
	(350)			
Operating excess after transfers	$ 595			
Interest expense	(75)			(75)
Investment return, net	170		445	615
Transfers (to)/from operating activities:				
Aggregate of transfers to operating activities	(150)	a		(150)
Aggregate of transfers from operating activities	500	b		500
	350		-	
Total change in net assets	**1,040**		**570**	**1,610**
Net assets at the beginning of the period	**1,500**		**2,100**	**3,600**
Net assets at the end of the period	**$ 2,540**		**$ 2,670**	**$ 5,210**

(a)(b) Amounts and purposes of aggregated transfers that are presented on the face would be disclosed in the notes to the financial statements.

Operating Nonoperating w/o donor restrictions, With donor restrictions

Cash Flow Statement

- Proposes to require **Direct Method** for operating cash flows
  - No longer require Indirect Method
- Proposes to re-categorize certain items to better align "operating" with activities statement and operating measure
  - Purchases of and proceeds on sale of long lived assets (e.g. PP&E)
  - Cash gifts restricted for long lived assets
  - Cash from interest and dividends
  - Interest paid on long term debt

Cash Flow Statement

Cash Flows from Operating Activities	
Cash received from service recipients	
Cash received from donors	
Cash paid to employees	
Cash paid to vendors	
Purchase of property and equipment	
Proceeds on sale of property and equipment	
Contributions restricted for property and equipment	
Net cash from operating activities	
Cash Flows from Investing Activities	
Cash received from interest and dividends	
Purchase of investment assets	
Proceeds from sale of investments	
Net cash from investing activities	
Cash Flows from Financing Activities	
Payments of principal on long-term debt	
Interest paid on long-term debt	
Contributions restricted for endowment	
Net cash from financing activities	
Net increase in cash	
Cash at the beginning of year	
Cash at end of year	

QUESTIONS?

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