2019 Accounting & Auditing Update
AGENDA

FASB Pronouncements:

- Revenue Recognition
- Contributions
- Not-for-Profit Reporting
- Leases

GASB Pronouncements:

- Leases
- Fiduciary Activities
- Capitalized Interest
FASB

ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)
CORE PRINCIPLE

- Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.
SCOPE

- All entities that enter into contracts with customers
  - Public, private, not-for-profit
  - Regardless of industry
- All contracts with customers except:
  - Lease contracts
  - Insurance contracts
  - Financial instruments
  - Guarantees
  - Nonmonetary exchanges between entities in the same business to facilitate sales to customers
- Excludes:
  - Contributions
  - Collaborative agreements
### EFFECTIVE DATES

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public entities, including conduit debt obligors</td>
<td>Fiscal years beginning after December 15, 2017, including interim periods therein</td>
</tr>
<tr>
<td>Nonpublic entities</td>
<td>Fiscal years beginning after December 15, 2018, including interim periods therein</td>
</tr>
</tbody>
</table>
REVENUE RECOGNITION PROCESS

1. Identify Contract with a Customer
2. Identify Performance Obligations
3. Determine the Transaction Price
4. Allocate the Transaction Price
5. Recognize Revenue When (or As) a Performance Obligation is Satisfied
STEP 1: IDENTIFY CONTRACTS WITH A CUSTOMER

- Must create enforceable rights and obligations
  1. Approval and commitment of the parties (in writing, orally, or in accordance with other customary business practices)
  2. Identification of the rights of the parties
  3. Identification of the payment terms
  4. The contract has commercial substance
  5. It is probable that the entity will collect the money it is entitled to for providing the service
EXAMPLE: ELECTIVE VS. EMERGENT

Scenario # 1:
- Elective procedure – a signed patient consent form

Scenario #2:
- Emergent patient – patient enters the hospital through the emergency room unconscious and upon arrival, services are immediately provided
COLLECTABILITY

- Collectability will be explicit threshold that must be assessed before applying revenue recognition model to contract
  - Entity must evaluate credit risk and conclude “probable” amount to be collected
- Assessment based on both customer’s ability and intent to pay amounts due
- Difficult for health care entities to assess
- No such thing as cash basis in the revenue recognition model
STEP 2: IDENTIFYING PERFORMANCE OBLIGATIONS

- Performance obligation – promise in a contract to transfer a good or service to customer

- Identify all **distinct** performance obligations in the contract
  - Capable of being distinct
  - Distinct within the context of the contract
Scenario # 3:
- Assisted living facility resident
- Contract separately identifies room and board, cable and hair cuts
- Standard charges per month:
  - Room and board: $6,000
  - Cable: $30
  - Hair cuts: $15
- Allowable under insurance contract - $2,000 per month for room and board
STEP 3: DETERMINING THE TRANSACTION PRICE

- Transaction price – amount of consideration for goods or services provided to the customer
  - Variable consideration
  - Constraining estimates of variable consideration
  - Existence of significant financing component
  - Noncash consideration
  - Consideration payable to the customer
- Consideration is variable if explicitly stated, or if
  - Customer has valid expectation arising from entity’s customary business practices – accept amount less than stated contract
  - Other facts or circumstances indicate entities intention to offer price concession
PORTFOLIO APPROACH

- Entities must reasonably expect that the financial statements effect of using the portfolio approach will not differ materially from applying the standard contract-by-contract basis

- Key considerations:
  - How to apply a portfolio approach
  - How to establish portfolios
  - How to determine effect would not differ materially

- Health care entities may consider segregating by payer class, type of service and other categories
Scenario # 4:
- Emergency room patient – uninsured
- Due to patient’s condition, medical services provided upon arrival
- Standard ED charges - $10,000
- Patient does not meet charity care policy
- Estimated collectability at the time of service - $1,000
- How much revenue would you expect to record?
STEP 4: ALLOCATE THE TRANSACTION PRICE

- If multiple performance obligations, transaction price must be allocated based on their standalone selling price
- Allocation of any discount should also be proportionate
- Two exceptions:
  - Terms of variable payment are specific to one performance obligations
  - Allocate discount to only those goods or services to which it relates
Scenario # 5:
- Broken bone and corrective surgery – discrete surgery
- Standard charges
  - Broken bone: $2,000
  - Corrective surgery: $18,000
- Uninsured patient
- Estimated collectability at the time of service - $2,000
- What is the transaction price allocation?
STEP 5: RECOGNIZE REVENUE WHEN (OR AS) A PERFORMANCE OBLIGATION IS SATISFIED

- Revenue recognized by satisfying performance obligation when control over good or service is transferred to customer
INCOME STATEMENT – NOW AND THEN

Before:

Unrestricted Revenues, Gains and Other Support

- Patient service revenue (net of contractual discounts and allowances)
  - 2018: $, 2017: $
- Less: Provision for uncollectible accounts
  - 2018: ____, 2017: ____
- Net patient service revenue, less provision for uncollectible accounts
  - 2018: ____, 2017: ____
- Other revenue
  - 2018: ____, 2017: ____

Total unrestricted revenues, gains and other support

After:

Revenues, Gains and Other Support Without Donor Restrictions

- Patient service revenue
  - 2019: $, 2018: $
- Other revenue
  - 2019: ____, 2018: ____

Total revenues, gains and other support without donor restrictions

Expenses

- Salaries and wages
  - 2019: ____, 2018: ____
- Employee benefits
  - 2019: ____, 2018: ____
- Professional fees and purchased services
  - 2019: ____, 2018: ____
- Provision for uncollectible accounts
  - 2019: ____, 2018: ____

Total expenses
DISCLOSURES

- Per ASC 606-10-50
  - Revenue from contracts with customers, including the disaggregation of revenue in appropriate categories
  - Contract balances, including the opening and closing balances of receivables, contract assets and contract liabilities
  - Revenue recognized in the reporting period that was included in the contract liability at the beginning of the period
  - Revenue recognized in the reporting period that performance obligations satisfied
  - Significant judgments and changes in judgments, made in applying the requirements to those contracts
WHAT TO DO NOW?

1. Review standard and related resources
2. Identify a champion or task force to implement
3. Identify revenue streams and document process, analysis and conclusion for each
4. Collaborate with others in industry
5. Determine changes needed and educate audit committees and boards
HELPFUL RESOURCES

- FASB ASU No. 2014-09
- AICPA A&A Guide *Revenue Recognition*
- AICPA Website
- BKD Website
- BKD Thoughtware
- BKD White Paper
FASB

ASU 2018-08, Not-for-Profit Entities: Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (Topic 958)
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CONTRIBUTIONS VS. EXCHANGE TRANSACTIONS

- Exchange Transaction: if commensurate value **is received** by the resource provider, the transaction should be accounted for as an exchange transaction by applying ASC 606 or other topics.

- Contribution Transaction: if commensurate value **is not received** by the resource provider, i.e. nonexchange, the recipient organization would record the transaction as a contribution under ASC 958 & determine whether the contribution is conditional or unconditional.
CONSEQUENTIAL OR UNCONDITIONAL CONTRIBUTIONS

- Organization would evaluate whether contributions ("nonexchange" transactions) are conditional or unconditional by determining whether there is a barrier or hurdle that must be overcome & whether the agreement or other referenced document includes either a right of return of assets transferred or a right of release of a promisor’s obligation to transfer assets.

- To determine if there is a barrier, an NFP will consider indicators, which include, but are not limited to:
  - The inclusion of a measurable performance-related barrier or other measurable barrier
  - The extent to which a stipulation limits discretion by the recipients on the conduct of an activity
  - The extent to which a stipulation is related to the purpose of the agreement
REVENUE RECOGNITION DECISION TREE

Transaction in which each party directly receives commensurate value?

NO → Nonreciprocal transactions. Apply contribution (nonexchange) guidance

NO → Conditions present, i.e., right of return/release & barrier?

YES → Conditional – recognize revenue when condition is met

NO → Restrictions present, i.e., limited purpose or timing?

NO → Unconditional & without restrictions (unrestricted)

YES → Unconditional & restricted

YES → Reciprocal transaction. Apply rev rec (ASC 606) or other guidance
EXAMPLE – THIRD PARTY PAYMENT

- NFP hospital provides medical services to a patient
- The patient has Medicare
- Total billed charges of $10,000
- Medicare pays $8,000
- Patient pays $2,000

Exchange or nonexchange? If nonexchange, conditional or unconditional?
EXAMPLE – THIRD PARTY PAYMENT

- Exchange Transaction
  - Services provided by the hospital have commensurate value for the patient
  - The source of payment for this transaction does not impact the conclusion
EXAMPLE – FEDERAL GRANT

- NFP is awarded a research grant from federal government

- Agreement requires NFP hospital to:
  - Follow OMB regulations and cost principles
  - Obtain an annual audit
  - Submit summary of research findings to federal government

- Unused assets are forfeited & unallowed costs are required to be refunded

- NFP hospital retains rights to the research findings

Exchange or nonexchange? If nonexchange, conditional or unconditional?
EXAMPLE – FEDERAL GRANT

- Nonexchange Transaction
  - NFP hospital retains rights to findings
  - Commensurate value not exchanged – the general public benefits from the findings

- Conditional
  - Grant limits discretion on how assets may be spent
  - Right of return and release

Note: audit requirement alone is not a barrier because it is not related to the purpose of the agreement
EXAMPLE – RESEARCH GRANT

- Large NFP with a cancer research center receives $500K from a pharmaceutical entity to finance a clinical trial
- Pharmaceutical entity specifies the protocol of the testing (i.e. participants, dosages, frequency)
- Agreement requires a detailed report of test outcomes
- Pharmaceutical entity retains the rights to the result of the study

Exchange or nonexchange? If nonexchange, conditional or unconditional?
EXAMPLE – RESEARCH GRANT

- Exchange Transaction
  - Results of the clinical trial have commercial value for the pharmaceutical entity (Topic 606)
EXAMPLE – PRIVATE FOUNDATION

- NFP hospital’s foundation started a building campaign with a goal of $1M
- The NPF receives a pledge from private foundation of $400K and requires the NFP to:
  - Secure pledges for the entire $1M campaign goal
  - Obtain signed construction contract for the building
- Right of release included in agreement

Exchange or nonexchange? If nonexchange, conditional or unconditional?
EXAMPLE – PRIVATE FOUNDATION

- Nonexchange Transaction
  - Foundation does not receive commensurate value

- Conditional
  - Agreement includes a measurable performance-related barrier
  - Right of release
FASB

ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958)
EFFECTIVE DATES

- NFPs are required to apply ASU 2016-14 for annual financial statements for fiscal years after December 15, 2017
  - January 1, 2018 – December 31, 2018
  - July 1, 2018 – June 30, 2019
  - October 1, 2018 – September 30, 2019
BACKGROUND & OVERVIEW

- Refresh & update, not overhaul, financial reporting model
- Simplify & improve net asset classification presentation
- Enhance information in statements & notes about
  - Financial performance
  - Cash flow
  - Liquidity
- Allow NFPs to “tell their financial story”
KEY CHANGES

- Net asset classes
- Natural & functional expense classification
  - Investment expenses
- Statement of cash flows
- Liquidity & availability resources
CHANGE IN NET ASSET CLASSIFICATIONS

- Current GAAP
  - Unrestricted
  - Temporarily restricted
  - Permanently restricted
- Revised GAAP
  - Without donor restrictions
  - With donor restricts
- Footnote requirements: disclose information about nature & amounts of different types of restrictions
**Net Assets**

**Without donor restrictions**
- Undesignated
- Designated by the Board for endowment

**With donor restrictions**
- Perpetual in nature
- Purpose restrictions
- Time-restricted for future periods

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undesignated</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Designated by the Board for endowment</td>
<td></td>
<td></td>
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<tr>
<td>Perpetual in nature</td>
<td></td>
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<tr>
<td>Purpose restrictions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time-restricted for future periods</td>
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<td></td>
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<tr>
<td><strong>Total net assets</strong></td>
<td></td>
<td></td>
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</table>
# Change in Net Asset Classifications

## Statement of Activities - Columnar

<table>
<thead>
<tr>
<th></th>
<th>2019 Without Donor Restrictions</th>
<th>2019 With Donor Restrictions</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td><strong>Revenues, Gains and Other Support</strong></td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Patient service revenue</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other revenue</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total revenues, gains and other support without donor restrictions</strong></td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Salaries and wages</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Professional fees and purchased services</td>
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<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Provision for uncollectible accounts</td>
<td>$</td>
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</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>$</td>
<td>$</td>
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</table>
## CHANGE IN NET ASSET CLASSIFICATIONS

### STATEMENT OF ACTIVITIES – SINGLE COLUMN

<table>
<thead>
<tr>
<th>Changes in net assets without donor restrictions:</th>
<th>2019</th>
<th>2018</th>
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<tbody>
<tr>
<td>Revenues and gains:</td>
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<td>Patient service revenue</td>
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<tr>
<td>Other revenue</td>
<td></td>
<td></td>
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<tr>
<td>Total revenues, gains without donor restrictions</td>
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<tr>
<td>Net assets released from restrictions:</td>
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<td></td>
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<tr>
<td>Satisfaction of equipment acquisition restrictions</td>
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<tr>
<td>Expiration of time restrictions</td>
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<tr>
<td>Total net assets released from restrictions</td>
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<tr>
<td>Total revenues, gains and other support without donor restrictions</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Expenses:</th>
<th>2019</th>
<th>2018</th>
</tr>
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<td>Salaries and wages</td>
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<tr>
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<tr>
<td>Total expenses</td>
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<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Changes in net assets with donor restrictions:</th>
<th>2019</th>
<th>2018</th>
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</thead>
<tbody>
<tr>
<td>Contributions received</td>
<td></td>
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<tr>
<td>Investment return, net</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in interest in net assets of Foundation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in beneficial interest in perpetual trusts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets released from restriction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in net assets with donor restrictions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in total net assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2019</td>
<td>2018</td>
</tr>
<tr>
<td>--------------------------------------</td>
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</tr>
<tr>
<td><strong>Net Assets Without Donor Restrictions</strong></td>
<td></td>
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<tr>
<td>Excess (deficiency) of revenues over expenses</td>
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<tr>
<td>Contributions of or for acquisition of PPE</td>
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<td></td>
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<tr>
<td>Transfers from (to) affiliates</td>
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<td></td>
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<tr>
<td>Net assets released from restriction used for PPE</td>
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<td></td>
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<tr>
<td>Increase (decrease) in net assets without donor restrictions</td>
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<td></td>
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<tr>
<td><strong>Change in Net Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Assets, Beginning of Year</strong></td>
<td></td>
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<tr>
<td><strong>Net Assets, End of Year</strong></td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>
EXPENSES

- Required to report expenses by function & nature in one location
  - Statement of Activities
  - Footnotes
  - Schedule of Functional Expenses
- Required to show relationship between functional area & natural class
- Investment expenses net with investment return
## EXPENSES

<table>
<thead>
<tr>
<th></th>
<th>Health Care Services</th>
<th>General &amp; Administrative</th>
<th>Fundraising</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>Salaries and wages</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
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</tr>
<tr>
<td>Total expenses</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>
Still have the choice to use the direct method or indirect method

Indirect reconciliation is no longer required if you utilize the direct method
LIQUIDITY DISCLOSURES

- Qualitative Disclosures
  - Information on how you manage liquid resources
  - Strategy for addressing risks that may affect liquidity
  - Policy for establishing liquidity reserves

- Quantitative Disclosures
  - Information that communicates availability of financial assets at financial statement date to meet cash needs within one year
  - Can be within the Statement of Financial Position or in the notes
LIQUIDITY DISCLOSURES

Financial assets, at year-end $ 

Less those unavailable within one year, due to restrictions:
  Restricted by donor with time or purpose restrictions
  Subject to appropriation and satisfaction of donor restrictions
  Investments held in annuity trust

Board designations:
  Amounts set aside for liquidity reserve 

Financial assets available to meet cash needs for 
  general expenditures 

Financial assets available for general expenditure, that is, without donor restrictions limiting their use, within one year of the balance sheet date, comprise the following:

  Cash and cash equivalents $ 
  Accounts receivable 
  Operating investments 
  Promises to give 
  Distributions from beneficial interests in assets held by others 

FASB

ASU 2016-02, Leases (Topic 842)
An arrangement contains a lease only when such arrangement conveys the “right to control” the use of an “identified asset.”

An arrangement can contain a lease even without control of the use of the asset if the customer takes substantially all of the output over the term of the arrangement.

For contracts that include substantial services, evaluating whether the arrangement meets the definition of a lease could require significant judgement. Accordingly, the revised definition of a lease could result on some arrangements receiving different accounting treatment compared to current guidance.
LEASE CLASSIFICATION

<table>
<thead>
<tr>
<th>New Guidance</th>
<th>Existing GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elimination of bright lines &amp; addition of one additional criterion: If the underlying asset is of such a <strong>specialized nature</strong> that it is expected to have no alternative to the lessor, the lease is a finance lease.</td>
<td>Bright-line test: A lease is a capital lease if the lease is for a major portion of the asset’s life (75%) or payments represent substantially all of the asset’s value (90%).</td>
</tr>
<tr>
<td>The determination of whether or not a contract is a lease or contains a lease is done at lease <strong>inception</strong>. Lease classification, recognition &amp; measurement are determined at the lease <strong>commencement date</strong>.</td>
<td>Assumptions relevant to classification &amp; measurement are determined at lease <strong>inception</strong>. Recognition of rent expense or capital lease assets &amp; liabilities begin at the lease <strong>commencement date</strong>.</td>
</tr>
</tbody>
</table>

The lack of explicit bright lines will increase the level of judgment required when classifying a lease – particularly for certain highly structured transactions. However, the basis for conclusions acknowledges that one reasonable approach would be to use the bright-line tests.

Transition reliefs permit an entity to avoid reassessment of lease classification for existing leases at the day of adoption & avoid reassessment of initial direct costs previously capitalized (some of which may no longer qualify for capitalization).
LEASE CLASSIFICATION

- Financing lease criterion:
  - Transfer of ownership by the end of the lease term
  - Option to purchase the underlying asset (reasonably assured to exercise)
  - Term is for a major part of the remaining economic life of the asset
  - Present value of the sum of lease payments $\geq$ substantially all of the FV of the asset
  - The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term
## COMPARISON OF LESSEE MODELS

### Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th>Finance Lease</th>
<th>Operating Lease</th>
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</thead>
<tbody>
<tr>
<td>Right of Use (ROU) Asset *</td>
<td></td>
<td>Right of Use (ROU) Asset **</td>
</tr>
<tr>
<td>Lease Liability</td>
<td></td>
<td>Lease Liability</td>
</tr>
</tbody>
</table>

*Periodically reduced by straight-line amortization

** Periodically reduced by the difference between straight-line lease expense & interest cost on lease liability, *i.e.*, “plug figure”
EFFECT ON BALANCE SHEET

- Operating Lease Example:
  - Lessee signs a lease for a building on January 1, Year 1
  - Lease period is 10 years
  - Annual payment is $1,627,049
  - Lessee’s incremental borrowing rate is 10%
  - PV of lease payments (computed) is $10,000,000
  - Economic life is 20 years
  - Estimated FV is $20,000,000
  - Building transfers back to the lessor at the end of the term

1/1/Y1   Right-of-Use Asset   $10,000,000
         Lease Liability         $10,000,000
## EFFECT ON BALANCE SHEET

<table>
<thead>
<tr>
<th></th>
<th>Current GAAP</th>
<th>ASU 2016-02</th>
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<tbody>
<tr>
<td><strong>Total current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Lease Assets (ROU Asset)</strong></td>
<td>2,200</td>
<td>2,200</td>
</tr>
<tr>
<td><strong>Property, plant &amp; equipment</strong></td>
<td>67,000</td>
<td>67,000</td>
</tr>
<tr>
<td><strong>Total noncurrent assets</strong></td>
<td>94,200</td>
<td>94,200</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>127,200</td>
<td>127,200</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>55,000</td>
<td>55,000</td>
</tr>
<tr>
<td><strong>Lease Liabilities</strong></td>
<td>1,900</td>
<td>1,900</td>
</tr>
<tr>
<td><strong>Borrowings</strong></td>
<td>27,000</td>
<td>27,000</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>83,900</td>
<td>93,900</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td>43,300</td>
<td>43,300</td>
</tr>
<tr>
<td><strong>Total Liabilities &amp; Equity</strong></td>
<td>$127,200</td>
<td>$137,200</td>
</tr>
</tbody>
</table>

Recognizing operating leases on the balance sheet will have minimal, if any, effect on the income statement or statement of cash flows compared to current GAAP.
# COMPARISON OF LESSEE MODELS

## Income Statement

<table>
<thead>
<tr>
<th>Finance Lease</th>
<th>Operating Lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense (on lease liability)</td>
<td>Lease/Rent Expense (straight-line)</td>
</tr>
<tr>
<td>Amortization Expense (on ROU asset)</td>
<td></td>
</tr>
</tbody>
</table>
## EFFECT ON INCOME STATEMENT

<table>
<thead>
<tr>
<th></th>
<th>Operating Lease</th>
<th>Finance Lease</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue &amp; other income</strong></td>
<td>$175,000</td>
<td>$175,000</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>(150,000)</td>
<td>(150,000)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Operating costs</strong> (includes operating lease expense)</td>
<td>(13,300)</td>
<td>(11,700)</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td>11,700</td>
<td>13,300</td>
</tr>
<tr>
<td><strong>Depreciation &amp; amortization (includes ROU amortization - finance lease)</strong></td>
<td>–</td>
<td>(6,833)</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>11,700</td>
<td>6,467</td>
</tr>
<tr>
<td><strong>Net finance costs</strong> (includes interest expense – finance lease)</td>
<td>(1,300)</td>
<td>(2,940)</td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td>10,400</td>
<td>3,527</td>
</tr>
<tr>
<td><strong>Income tax</strong></td>
<td>(1,300)</td>
<td>(1,146)</td>
</tr>
<tr>
<td><strong>Profit for year</strong></td>
<td>$9,100</td>
<td>$2,381</td>
</tr>
<tr>
<td><strong>Leverage Ratios</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total commitments (borrowings plus lease liabilities) to EBITDA</td>
<td>Higher</td>
<td>Lower</td>
</tr>
</tbody>
</table>


## COMPARISON OF LESSEE MODELS

### Cash Flow Statement

<table>
<thead>
<tr>
<th>Finance Lease</th>
<th>Operating Lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid for principal payments as financing activities; interest &amp; variable lease payments as operating activities</td>
<td>Cash paid for lease payments as operating activities</td>
</tr>
</tbody>
</table>
## EFFECTIVE DATE

<table>
<thead>
<tr>
<th>Entity</th>
<th>Annual Periods</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public entities</strong></td>
<td><strong>Beginning after December 15, 2018</strong></td>
</tr>
<tr>
<td>1. A public business entity</td>
<td></td>
</tr>
<tr>
<td>2. A NFP entity that has issued or is a conduit debt obligor for securities traded, listed, or quoted on an exchange or over-the-counter market</td>
<td></td>
</tr>
<tr>
<td>3. An employee benefit plan that files or furnishes financial statements with or to the SEC</td>
<td></td>
</tr>
<tr>
<td><strong>All other entities (nonpublic entities)</strong></td>
<td><strong>Beginning after December 15, 2019</strong></td>
</tr>
</tbody>
</table>
GASB

Statement No. 87, *Leases*
**GASB – DEFINITION OF A LEASE**

<table>
<thead>
<tr>
<th>New Guidance</th>
<th>Existing GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.</td>
<td>An agreement can contain a lease even without control of the use of the asset if the customer takes substantially all of the present service capacity from the underlying asset’s use.</td>
</tr>
</tbody>
</table>

*GASB Statement No. 87 replaces the term “agreement” under current guidance with the term “contract” to require that a lease – whether written or verbal – is legally enforceable.*
LEASE CLASSIFICATION

- For all leases the lessee will record a lease liability and a right-of-use asset
- No distinction of lease types (differs from FASB)
- Exceptions:
  - Does not include short-term contracts
  - Contracts that transfer ownership of the underlying asset
  - Intangible, financial, or biological assets
  - Must be exchange or exchange-like
  - Supply contracts
## LEASE RECOGNITION

### Balance Sheet

<table>
<thead>
<tr>
<th>Lease Liability</th>
<th>Intangible ROU Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measured at the present value of future lease payments expected to be made during the lease term</td>
<td>Measurement based on the lease liability’s initial measurement, + prepayments at or before commencement of lease term, - Lease incentives, + Direct costs to place leased asset in use</td>
</tr>
<tr>
<td>Does not include payments based on performance or usage</td>
<td></td>
</tr>
</tbody>
</table>
## LEASE RECOGNITION

### Income Statement

<table>
<thead>
<tr>
<th>Interest Expense</th>
<th>Amortization Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognize interest expense related to discount amortization</td>
<td>Recognize amortization expense representing the decrease in useful life of the right to use the underlying asset</td>
</tr>
</tbody>
</table>
EFFECTIVE DATE & TRANSITION GUIDANCE

- Effective for reporting periods beginning after December 15, 2019
- Provisions should be retroactively applied by restating prior financial statements for all periods presented
- Reasonable efforts should be employed before determining restatement is not practical – “inconvenient” is not a baseline for not restating
- Based on facts & circumstances that existed at the beginning of the implementation period or the beginning of the earliest period restated
# GASB VS. FASB – KEY DIFFERENCES

<table>
<thead>
<tr>
<th>Topic</th>
<th>GASB Statement 87</th>
<th>FASB Topic 842</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition</td>
<td>Exchange or exchange-like transaction</td>
<td>In exchange for consideration</td>
</tr>
<tr>
<td>Lease classification</td>
<td>No classification</td>
<td>Classify as operating or financing</td>
</tr>
<tr>
<td>Short-term leases</td>
<td>Required exception if meets definition</td>
<td>Policy election</td>
</tr>
<tr>
<td>Short-term lease definition</td>
<td>Maximum possible term of 12 months</td>
<td>Lease term of 12 months</td>
</tr>
<tr>
<td>Initial direct costs – lessee</td>
<td>Expense or capitalize consistent with capital assets and debt issuance</td>
<td>Capitalize</td>
</tr>
</tbody>
</table>
WHAT TO DO NOW?

1. Review standard and related resources

2. Inventory all lease contracts & determine whether other contracts contain leases

3. Determine appropriate level at which to aggregate or disaggregate disclosures

4. Collaborate with others in industry

5. Consider business implications, educate audit committees, boards and any other key stakeholders
GASB

Statement No. 84, *Fiduciary Activities*
BACKGROUND

- Improves guidance regarding the identification of fiduciary activities and how those activities should be reported
- Clarifies when a government has a fiduciary responsibility and is required to present fiduciary fund financial statements
- Covers governments and business-type activities
- Effective for fiscal years beginning after December 15, 2018; early application encouraged
IDENTIFYING FIDUCIARY ACTIVITIES

- A primary government or its component units may be engaged in fiduciary activities
- Fiduciary activities fall into one of four categories
  - Component units that are postemployment benefit arrangements
  - Component units that are not postemployment benefit arrangements
  - Postemployment benefit arrangements that are not component units
  - All other activities
COMPONENT UNIT DETERMINATION

- Legally separate from the primary government
- Primary government is financially accountable
  - Test 1: Voting majority of board, AND
    - Imposition of will, or financial benefit/burden
  - Test 2: Fiscally dependent
  - Misleading to exclude (GASB 39)
CONTROL OF ASSETS

Postemployment benefit arrangements that are not component units are fiduciary activities if the government controls the assets

- Government holds the assets, or
- Government has the ability to direct the use, exchange, or employment of assets for the benefit of specified or intended recipients
  - A trustee of a pension/OPEB following the policies and instructions of the government
  - Appointing a designee to act on its behalf does not alter the government’s ability to direct the use, exchange or employment of assets
  - Restrictions on use of asset do not negate government’s control of the assets
  - If not assessed as a component unit, ordinarily the assets of most defined contribution plans (401K and 457) are NOT controlled by the sponsor
REPORTING

- Report balances of all fiduciary funds
- Liability to beneficiaries
- Pension or OPEB plans report in accordance with GASB 67 or 74 as applicable
## WHAT TO DO NOW?


2. **Identify potential fiduciary population: bank accounts, component units, known resources controlled by not held by the government**

3. **Obtain documentation such as contracts/agreements, trust documents, originating documents**

4. **Gather information to understand who/what entity provided the resources, the purpose, and potential beneficiaries**

5. **Consult with auditors and advisors early as there will likely be additional auditing and testing procedures necessary**
GASB

Statement No. 89, Accounting for Interest Cost Incurred Before the End of a Construction Period
Inconsistent interest capitalization within government financial statements

- Capitalize interest incurred for assets in enterprise funds and business-type activities
- Don’t capitalize in governmental activities
GASB 89

- Board determined interest incurred prior to construction completion does not meet the definition of an asset in Concepts Statement 4
  - Expense for economic resources measurement
  - Expenditure for current financial resources measurement
IMPLEMENTATION

- Effective for periods beginning after December 15, 2019
- Early implementation is *encouraged*
- *Prospective* from beginning of period implemented; i.e. no need to back out previously capitalized interest
Thank You!

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Jessica Elsberry, Manager
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