Financial Reporting Changes Affecting Chambers

Nathan D. Franklin, CPA, CGMA

Franklin & Vaughn, LLC

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Welcome & Introduction

- Background & Contact Information
- Topics Covered:
    - Internal Controls/Best Practices for Small Offices
    - Understanding Financial Statements & CPA Services Offered
    - GAAP (Accrual Accounting) vs. Modified Cash Accounting
    - ASU 2016-14 (new financial reporting model for NFPs)
    - ASU 2014-09 (new revenue recognition standard for NFPs)
    - IRS Form 990: Tips, Tricks & Updates
- Disclaimer & Warning!
    - My opinions & viewpoints are my own
    - We are going to cover a lot of information and move quickly

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Internal Controls/Best Practices for Small Offices

- Basic Principle: Separate duties involving handling of monies (both receipts and disbursements) to the extent possible
- Ideas for Controls over Cash Receipts:
  - Rotate opening mail/review incoming mail/online payments
  - Dual count any actual cash received (ex. at fundraisers)
- Ideas for Controls over Cash Disbursements:
  - Require two signatures on checks and rotate check signers
  - Require approval & attachment of 3rd-party documentation
  - Minimize online/automatic payments
  - Annual review of vendor list

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Internal Controls/Best Practices for Small Offices

- Ideas for Controls over Payroll:
  - Management approval of time sheets, paid time off, etc.
  - Board approval of rate changes, benefit changes & new hires
  - Reconciliation of payroll records to general ledger

- Ideas for General Controls:
  - Independent receipt & review of bank statements
  - Timely completion & review of bank reconciliations
    - Prompt investigation & resolution of uncleared items
    - Brief memo/summary of cash activity for the period ended
  - Require periodic vacations for those handling monies

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Understanding Financial Statements

	End of Year 2	End of Year 1
Cash	$ 35,000	$ 40,000
Property & Equipment	10,000	5,000
Total Assets	$ 45,000	$ 45,000
Line of Credit	$ 8,000	$ 12,000
Net Assets	37,000	33,000
Total Liabilities & Net Assets	$ 45,000	$ 45,000

- Statement of Financial Position ("Balance Sheet")
  - Shows financial position at a particular "snapshot" in time
  - Tells the ability of the NFP to react to future events
  - Net income/loss for the period becomes part of "Net Assets"

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Understanding Financial Statements

	Year 2	Year 1
Dues	$ 18,000	$ 17,000
Fundraisers	11,000	9,000
Total Revenues	$ 29,000	$ 26,000
Program Services	$ 22,000	$ 21,000
Administrative	3,000	3,000
Total Expenses	$ 25,000	$ 24,000
Net Income	$ 4,000	$ 2,000

- Statement of Activities ("Income Statement" or "Profit/Loss Statement")
  - Shows financial performance over a particular "duration" of time
  - Tells the ability of the NFP to manage its resources well
  - Net income/loss for the period becomes part of "Net Assets"

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Understanding Financial Statements

Year 2 only	Program Services	Administrative
Personnel	$ 11,000	$ 1,500
Occupancy	2,000	500
Insurance	2,000	500
Office	-	500
Membership	7,000	-
Total Expenses	$ 22,000	$ 3,000

- Statement of Functional Expenses
  - A detailed description of expenses for the period, classified by both function and category
  - Totals agree to total expenses on the Statement of Activities

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Understanding Financial Statements

		Year 2 only
Cash Receipts	$	29,000
Cash Disbursements		(25,000)
Line of Credit Payment		(4,000)
Equipment Purchase		(5,000)
Net Change in Cash	$	(5,000)
Cash, Beginning of Year		40,000
Cash, End of Year	$	35,000

- Statement of Cash Flows
  - Converts the net income/loss for the period as reported on the Statement of Activities to the net change in cash for the period
  - Reconciles beginning and ending cash balances for the period
  - Classified as follows:
    - Operating cash flows
    - Financing cash flows
    - Investing cash flows

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Financial Statement Services Offered by CPAs

- Preparation
  - No CPA report. Financial statements are printed/e-mailed on blank paper. CPA includes a note on each statement disclaiming any assurance provided.
- Compilation
  - CPA report which states that the CPA provides <u>no opinion</u>, <u>conclusion</u>, or <u>any form of assurance</u> on the financial statements. Information provided by management is presented in the form of financial statements.
- Review
  - CPA report which provides the CPA's <u>conclusion</u> of <u>limited assurance</u> that no material modifications need to be made to the financial statements. Consists primarily of analytical procedures and inquiries of management.
- Audit
  - CPA report which provides the CPA's <u>opinion</u> of <u>reasonable assurance</u> that the financial statements are presented fairly in all material respects. Performed in accordance with <u>G</u>enerally <u>A</u>ccepted <u>A</u>uditing <u>S</u>tandards.

Accounting Basis – Accrual vs. Modified Cash

- Accrual
  - GAAP (Generally Accepted Accounting Principles) requires financial statements to be presented using the accrual basis
  - Revenues – recognized when a good/service is performed and the right to receive consideration is earned (i.e. increase an asset or decrease a liability)
  - Expenses – recognized when a good/service is consumed and the obligation to give consideration is incurred (i.e. increase a liability or decrease an asset)
- Modified Cash
  - Assets, liabilities, revenues and expenses can only be recorded in the accounting records as a result of the occurrence of a cash transaction
- Main Differences
  - Accrual includes Accounts Receivable & Accounts Payable; Modified Cash does not
  - Modified Cash is simpler and often used by smaller organizations who are more interested in cash flow performance than in profit/loss performance
  - The key difference is timing of revenue and expense recognition

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New Financial Reporting Model

- ASU 2016-14
- Applies to <u>all</u> NFPs, no matter the basis of accounting
  - Requires all NFPs to now present a statement of functional expenses
  - Requires all NFPs to provide information about the liquidity and availability of the organization's resources. Most commonly included in a footnote such as follows (summarized):
    - NFP had $35,000 of cash available at the end of Year 2 to meet cash needs within one year for general expenses. As part of its liquidity management, NFP structures its financial assets to be available as general expenses, liabilities, and other obligations become due.
  - Simplifies the presentation of net asset classifications

New Financial Reporting Model

Year 2 only	Without Restrictions	With Restrictions
Dues	$ 18,000	$ -
Fundraisers	9,000	2,000
Total Revenues	$ 27,000	$ 2,000
Program Services	$ 22,000	$ -
Administrative	3,000	-
Total Expenses	$ 25,000	$ -
Net Income	$ 2,000	$ 2,000

- Statement of Activities ("Income Statement" or "Profit/Loss Statement")
  - All activities are now classified into two categories:
    - Without Restrictions (by donors, etc.)
    - With Restrictions (Net income/loss for the period becomes part of "Net Assets with Restrictions")

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New Financial Reporting Model

	End of Year 2	End of Year 1
Total Assets	$ 45,000	$ 45,000
Line of Credit	$ 8,000	$ 12,000
Net Assets without Restrictions	35,000	33,000
Net Assets with Restrictions	2,000	-
Total Liabilities & Net Assets	$ 45,000	$ 45,000

- Statement of Financial Position ("Balance Sheet")
  - Net Assets are now classified into two categories:
    - Without Restrictions (by donors, etc.)
    - With Restrictions (see related Statement of Activities)

New Revenue Recognition Standard

- ASU 2014-09
- Applies only to NFPs presenting GAAP financial statements (accrual basis of accounting)
- Contributions and investment income are not subject to the standard
- A shift in thinking about revenue
  - Old logic – revenues are recognized as an earnings process is completed
  - New logic – revenues are recognized after specific objectives have been accomplished/specific hurdles have been cleared. There are five such hurdles.

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New Revenue Recognition Standard

- Hurdle 1 – identifying the contract with a customer
- Contract may be written, oral or even implied
- Contract must create both rights and obligations
- A contract does not exist if either party has the unilateral ability to terminate
- Example: Chamber X has a December 31 year-end and bills its members for the upcoming year on December 31. Does Chamber X have a contract with each member:
  - A) on December 31 when it bills the member?
  - B) on the date (after January 1) that it receives the renewal payment from the member?

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New Revenue Recognition Standard

- Hurdle 2 – identifying the performance obligations in the contract
- A performance obligation is a promise in the contract with a customer to transfer a good or service to the customer
- Example: The annual membership fee for Chamber X is $300. Chamber X has determined that $100 of this amount is a contribution and the remaining $200 is a contract for benefits received by the member, consisting of a) a ticket to the Chamber's annual fundraiser in July; b) a monthly newsletter; c) intangible economic benefits associated with membership in Chamber X.

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New Revenue Recognition Standard

- Hurdle 3 – determining the transaction price
- The transaction price is the amount of consideration that the NFP expects to receive in exchange for transferring the promised goods or services to the customer
- The NFP should consider the terms of the contract and its customary business practices in determining the transaction price
- Chamber X has determined that the total benefits provided to its members (fundraiser ticket, monthly newsletter, benefits of membership) are fairly valued at $200

New Revenue Recognition Standard

- Hurdle 4 – allocating the transaction price to the performance obligations in the contract
- Allocation is performed based on the stand-alone fair value of each of the distinct performance obligations
- An NFP should estimate a stand-alone fair value for a performance obligation if it is not directly observable
- Example: Chamber X has allocated the $200 value of its membership as follows: a) $40 is the fair value of a ticket to the July fundraiser; b) $60 is the fair value of twelve monthly newsletters ($5 each); c) $100 is the fair value of intangible economic benefits associated with membership in Chamber X

New Revenue Recognition Standard

- Hurdle 5 – recognizing revenue when (or as) each performance obligation is satisfied
- Revenue recognized when transferring the promised good or service to a customer is equal to the amount allocated to the satisfied performance obligation, which may be satisfied at a point in time or over time
- A good or service is transferred when (or as) the customer obtains control of it
- Chamber X membership example:
  - $100 contribution is 100% recognized as revenue immediately upon receipt of member's payment (contributions are <u>not subject</u> to the new standard)
  - $40 for ticket to fundraiser is recognized as revenue in the month of July
  - $5 is recognized as revenue each month for monthly newsletter ($60 total)
  - $8.33 is recognized as revenue each month for intangible economic benefits ($100 total)

New Revenue Recognition Standard

- Practical Notes to Remember:
  - Applies only to NFPs presenting GAAP financial statements
  - The closer the revenue stream aligns to the reporting period, the lesser the potential effect may be
  - Only affects revenue items "in progress" at the end of the reporting period. (But, you may need to re-evaluate which revenue items are "in progress"!)
  - Membership dues are no longer presented on a gross presentation (total membership dues billed [revenue] less dropped members [expense])
  - Instead, membership dues are presented on a net presentation (net membership dues collected [revenue])

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New Revenue Recognition Standard

	new way		old way	
Dues	$	400	$	1,500
Contributions		400		-
Fundraiser Tickets		160		-
Newsletters		240		-
Total Revenues	$	1,200	$	1,500
Dropped Members	$	-	$	300
Net Income	$	1,200	$	1,200

- Statement of Activities ("Income Statement" or "Profit/Loss Statement")
  - Facts: Five members of Chamber X are billed $300 for an annual membership using the details already discussed. Four members pay to renew, and one does not.

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IRS Form 990: Tips, Tricks & Updates

- Basic Premise: on IRS Form 990, the more information provided, the better! (not like other IRS returns!)
- Reconcile all numbers to CPA-prepared financial statements
- Page 1, Part I, Summary – provide a detailed narrative
- Page 2, Part III, question "did the organization undertake any significant program services during the year which were not listed on the prior Form 990?" Don't be hesitant to mark "yes" and provide an explanation.
- Mandatory E-Filing of IRS Form 990
  - For all calendar-year NFPs in 2020 (990 due May 15, 2021)
  - For non-calendar-year NFPs – effective for first fiscal year beginning on or after July 2, 2019

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Thank you for attending!

Nathan D. Franklin, CPA, CGMA

Franklin & Vaughn, LLC

#1 Sunset Hills Professional Center, Suite D

Edwardsville, IL 62025

(618) 307-0315 (office)

(314) 707-7872 (cell)

nathan@franklinvaughncpa.com

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