Common Mistakes in Financial Statements

Trainer: Denes L. Tobie, CPA, Partner

Agenda

- Gain an understanding of Findings based on your auditors perspective
- Review examples of Findings based on actual audits and learn what could have prevented or detected them
What is AU-C 265 and how does it effect our audits?

AU-C 265 – Identifying Deficiencies in Internal Control

“Communicating Internal Control Related Matters Identified in an Audit” establishes standards and provides guidance on communicating matters related to an entity’s internal control over financial reporting identified in an audit of financial statements.

It is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion).

Who does AU-C 265 apply to?

Applies to ALL entities that receive audits.
- Publicly traded
- Privately held
- Non-profit organizations
- There is no exemption for the size of the organization

Does it impact NPO’s differently?

It does effect organizations that have an Single Audit audit; due to the fact that the deficiencies that are either a significant deficiency or a material weakness must be disclosed in the Single Audit opinions.
**AU-C 265 mainly addresses three areas**

1. **DEFINES:** the terms *deficiency in internal control, significant deficiency* and *material weakness.*

2. **PROVIDES:** guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements.

3. **REQUIRES:** the auditor to *communicate, in writing,* to management and those *charged with governance* (e.g., the Board), significant deficiencies and material weaknesses identified in an audit.
Audit Findings

• In the audit of financial statements, the auditor is not required to perform procedures to identify deficiencies in internal control or to express an opinion of the effectiveness of the entity’s internal control.

• However, during the course of an audit, the auditor may become aware of deficiencies in internal control while obtaining an understanding of the entity and its environment; including assessing the risks of material misstatement of the financial statements due to error or fraud, performing further audit procedures to respond to assessed risks, communicating with management or others, or otherwise.

• The auditors awareness of deficiencies in internal control varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors.

What do we mean by Deficiency?

Deficiency in internal control – exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
Deficiencies in Internal Control – What are they?

A deficiency in design exists when:
- A control necessary to meet the control objective is missing; or
- An existing control is not properly designed so that, even if it operates as designed, the control objective is not always met.

Deficiencies in Internal Control – What are they?

A deficiency in operation exists when:
- A properly designed control does not operate as designed; or
- When the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.
Deficiencies in Internal Control – What are they?

- Material Weakness – a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

- A reasonable possibility exists when the likelihood of the event is either reasonably possible or probable.

Deficiencies in Internal Control – What are they?

- **Reasonably possible** – The chance of the future event or events occurring is more than remote but less than likely.

- **Probable** – The future event or events are likely to occur.
Deficiencies in Internal Control – What are they?

• Significant Deficiency – a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Deficiencies in Internal Control – What are they?

• From an auditor's standpoint we must conclude whether prudent officials, having knowledge of the same facts and circumstances, would agree with the auditor’s classification of the deficiency.

• In other words, would a prudent official, knowing what we know about the facts and circumstances, other controls tested, agree with our conclusion that a particular deficiency in internal control is not a significant deficiency or that a significant deficiency is not a material weakness.

• Unfortunately there is not a definition for the term prudent official.

• WWPOD?
Common Financial Statement Errors

Financial Statements Errors

- Financial statement amounts are not supported by general ledger amounts
- Statement of Financial Position
  - Improperly classifying assets and liabilities
  - Net assets not agreeing between statements
  - Statement not balancing
  - Footing and crossfooting the totals
    • Formula errors or hidden cells
  - Improper presentation
    • Missing necessary information
    • Debt issuance costs not shown net of debt
    • Net asset classification
      — Unrestricted/Temporarily Restricted/Permanently Restricted
      — Changing starting in 2018

Common Financial Statement Errors

Financial Statements Errors (cont.)

- Statement of Activities (cont.)
  - Improper presentation
    • No functional expense breakdown
    • Failure to show activity based on net asset restrictions
    • Failure to recognize releases from restriction
  - Improper classification of expenses
- Functional Expenses (Schedule or Statement)
  - Improper presentation in the financial statements
  - Improper classification of expenses
    • Management and General
    • Program
    • Fundraising
  - Totals not agreeing to other financial statements
Common Financial Statement Errors

Financial Statements Errors (cont.)
- Statement of Cash Flows
  - Improper classifications
    - Operating vs Financing vs Investing Activities
  - Amounts presented do not match the rest of the report
    - Financial statements
    - Footnotes
  - Missing supplemental disclosures
    - Amount of interest paid during the year
    - Amount of income taxes paid during the year (UBIT)

Common Financial Statement Errors

Footnote Errors
- Do not agree with financial statements
  - Most common errors here relate to capital outlay and debt payments.
- Missing/applicable footnotes and/or information
  - Missing disclosures on policies, accounting principles, and entity description
- Outdated footnotes
  - Missing updates related to any recent changes
    - Debt issuance costs
Common Financial Statement Errors

Supplemental Information Errors

- Schedule of Expenditures of Federal Awards (SEFA)
  - Expenditure amounts do not agree to underlying records or audited balances
  - Incorrect program name and CFDA Number
  - Missing necessary information
    - Passsthrough Agencies
    - Identifying information – Contract or passthrough number
    - Subrecipients identification and amounts provided to them
    - Noncash assistance
    - Missing loan programs and balances (Some loans not subject to requirement)

- Failure to identify clusters
  - Research & Development

- Missing or incorrect information in the notes to the SEFA
  - Indirect cost rate disclosure – use of the 10% de minimis rate
  - Basis of presentation
  - Summary of significant accounting policies

Supplemental Information Errors (cont.)

- Supplemental Schedules (varies by entity)
  - Balances do not agree with financial statements, footnotes etc…
Recent OIG Report Findings  
(and why you need training!)

Ineffective controls and accountability over its assets

- Assets not adequately safeguarded – inventory issues
- Bank reconciliations not timely and duties not properly segregated
- Grant drawdowns not always supported
- Employees did not obtain approval for credit card purchases
Recent OIG Report Findings (and why you need training!)

Questionable methods used to allocate shared costs

– Some shared costs may have been incorrectly allocated – couldn’t explain method

– Vacation, holiday and sick pay incorrectly allocated – didn’t follow salary allocations, used predetermined percentages

– No method for allocating shared equipment costs – did not address method

Recent OIG Report Findings (and why you need training!)

Unallowable costs claimed

– Costs did not directly benefit the program
Non-federal share was not always supported

- Non-federal share was not supported by documentation, therefore disallowed and subsequently did not have enough
- Non-federal share claimed was partially paid for by Federal funds
- Home activities were not specific, only said “home task” etc.
- Facility costs not supported
- Signatures missing

Procurement-related requirements were not always met

- Failure to obtain competitive bids or perform cost or price analysis
Recent OIG Report Findings (and why you need training!)

Some costs did not benefit the program
- Equipment did not benefit the program – sat idle for over a year
- Unallowable salaries and wages – wages for other programs charged to the HS program
- Unnecessary storage costs – storing obsolete and useless items and old files
- Costs not allocated in proportion to benefits received

Recent OIG Report Findings (and why you need training!)

Assets not adequately safeguarded
- Failure to follow property management standards – equipment records incomplete
Recent OIG Report Findings (and why you need training!)

Ineffective controls and accountability over funds
- Ineffective controls over payroll – timesheets not signed
- Bank reconciliations not timely – several months late, not signed off by preparer and reviewer

Accounting records were not always supported by source documentation
- Invoices missing
- Valid approval signatures missing
- Proof of payment missing
- Incorrect account classification
- Incorrect invoice amounts were paid

RESULTS?? One agency had $4,784 in unallowed costs the other…..over $550,000!!!
Sample Findings

MATERIAL ADJUSTMENTS (2018-01)
Condition
During our audit, Wipfli LLP proposed multiple adjusting journal entries which we deem to be material in relation to the financial statements. These entries were subsequently recorded by management. Since The NPO’s internal controls did not detect and correct these adjustments prior to the audit, a material weakness exists in The NPO’s controls over year end close and financial statement preparation.

Preventable? How?
Sample Findings

INTERNAL CONTROLS (2018-01)
Condition
While significant changes were made during the year to correct internal control deficiencies identified in previous audits, we did identify the following two internal control matters which constitute a significant deficiency in internal controls:

• At September 30, 2018, a number of invoices totaling approximately $315,000, were not recorded in accounts payable. While management was aware of the issue at the time of the audit, there was significant reconciling that needed to be performed on vendor account balances in order to determine the ultimate liability. Subsequently, management made an adjustment to accounts payable during the current audit year to properly reflect the actual liability.

• We selected a sample of 10 adjusting journal entries. In our sample, it was noted that two of the journal entries were not supported by adequate documentation to support the adjustment. In addition, two of the entries did not contain approval for the entries.

Sample Findings

PHYSICAL INVENTORY OF GRANT-FUNDED EQUIPMENT (2018-02)
Condition
During our audit, Wipfli LLP noted that there was inadequate evidence to indicate that The NPO performed a physical inventory of grant-funded equipment in the last two years, with an appropriate reconciliation to the general ledger.

Preventable? How?
Sample Findings

INTERNAL CONTROLS (2018-01) (cont.)

Condition

During the audit of The NPO, the following internal control matters were identified which constitute a material weakness in internal controls:

- We noted the Finance Director is the administrator for the general ledger accounting software, is an authorized check signer, receives the bank statements unopened, and reviews the bank reconciliation. As a result, there is not proper segregation of duties surrounding cash as the Finance Director has custody and control of cash.

- We noted a check with a November date that was issued to pay an invoice dated in December for approximately $3,500.

- We selected a sample of 10 adjusting journal entries. In our sample, it was noted that five of the journal entries were not supported by adequate documentation to support the adjustment. In addition, four of the entries contained only the approval of the Finance Director. We were unable to determine who the preparer of the entries was. This is a repeat finding.

Condition

During the audit of The NPO, the following internal control matters were identified which constitute a material weakness in internal controls:

- At the time of audit fieldwork, significant accounts were not reconciled and adjusted. Grants receivable, accounts payable, and grant funds received in advance were eventually reconciled by management after fieldwork but prior to issuing the audit report. This is a repeat finding.
Sample Findings

ALLOWABLE COSTS/COST PRINCIPLES (2018-01)

Condition

During our audit, Wipfli LLP noted that The NPO was incorrectly allocating shared costs intended as contract and service costs for one federal program to multiple other programs. This resulted in overcharging federal, state, and local program funds for approximately $76,000, of which $22,680 applied to the major program under audit. Because The NPO’s internal controls failed to detect and correct this error, there is a significant deficiency in internal control that resulted in a noncompliance.

Sample Findings

SEGREGATION OF DUTIES – PAYROLL (2018-02)

Condition

During our audit, Wipfli LLP reviewed and tested the internal controls over payroll processes. It was noted that one person was responsible for much of the payroll process, including the initiation of transactions, the updating of personnel information in the payroll system (including pay rates), the transmittal of payroll information to a third party service provider, and the reconciliation of the general ledger payroll accounts. Since The NPO’s internal controls did not provide for a proper segregation of duties, or adequate mitigating controls, a significant deficiency exists in The NPO’s controls.
Sample Findings

ELIGIBILITY (2018-01)
Condition

During our audit, Wipfli LLP noted that two out of a sample of 25 participants tested were noted to be ineligible for program services according to federal regulations regarding income levels for eligibility determination. Income levels for these two participants were clearly documented on intake forms as exceeding the federal poverty guideline specified for the program.

Sample Findings

FINANCIAL ACCOUNTING AND REPORTING (2018-01)
Condition

The preparation of annual GAAP financial statements requires an accounting standards expertise. In order to prepare GAAP basis financial statements, The NPO requested Wipfli LLP to assist in preparing the GAAP basis financial statements as part of our professional services for the year ended September 30, 2017. Our assistance in the preparation of The NPO's financial statements represents a significant deficiency in internal control over financial reporting.
Sample Findings

DATA COLLECTION FORM FILING (2018-03)
Condition
It was determined that the Data Collection Form (DCF) for the year ended September 30, 2016 was not submitted to the Federal clearinghouse within the earlier of 30 days after receipt of the auditor’s reports or nine months after the end of the audit period.

Sample Findings

CASH DISBURSEMENT APPROVAL (2018-02)
Condition
As part of our audit, we randomly tested twenty-five (25) checks to determine if there were adequate supporting documents, if the disbursement was allowable under Federal programs, and if there was proper approval of the disbursement. During our testing we noticed that six (6) of the cash disbursements in our sample were missing documentation of proper approval from the department, prior to being processed by the finance department. The disbursements were reviewed within the normal process of preparing the checks for signature and mailing, but no documentation exists of the approval by the department for which the disbursements were charged.
Sample Findings

ACCOUNT RECONCILIATIONS (2018-01)
Condition
As part of our audit testing, account reconciliations for various asset, liability and net asset accounts were obtained from management. In our testing of some of these reconciliations, we noted that they were inaccurate or incomplete. These same reconciliations did not have documentation that they were reviewed by management. These accounts were reconciled and adjusted during the audit process. The adjustments were not material to the financial statements.

Sample Findings

INTERNAL CONTROLS (2018-01)
Condition
During the course of the year, the Organization discovered that cash and checks collected at an offsite location were not timely transferred to the administrative office for recording in the accounting system and depositing in the bank account. Upon investigation, the Organization became aware that an employee at the client intake center had taken advantage of a lack of segregation of duties in this area and failed to bring the cash and checks to the administrative office.

The Organization implemented additional internal controls when this was discovered and terminated the employment of the employee. The Organization has done an assessment of the situation and has found that the monies were collected at the location from individual donors who were paying a fee for services received. The total amount collected and not properly deposited approximated $26,000. None of the monies stolen were from governmental funding sources.
Sample Findings

CASH MANAGEMENT (2018-02)
Condition

During our audit, Wipfli noticed that The NPO was charging its programs a set amount for all employees who were eligible for fringe benefits, regardless if the employee accepted all the benefits offered to them. As a result of this charge, the grants were overcharged for those employees who choose not to accept all the benefits for which they were eligible.

After the discovery of the finding, The NPO has fixed the error and the financial statements and schedule of expenditures of federal awards does not reflect an overcharge of federal grants.

ACCOUNTING SOFTWARE ACCESS AND THE ACCOUNTS PAYABLE FUNCTIONS (2018-01)
Condition

During the current year, The NPO installed new accounting software. We reviewed the access rights assigned to the accounting staff in the new software. Our review noted that one employee had access in the accounting software to all functions in the accounts payable area.

We also reviewed the current internal controls over the accounts payable function. While there are several controls in place, such as checks are signed only after a password is entered which this employee does not have access to, there are procedures that could be adopted to enhance controls. This condition results in a weakness in the accounts payable process.
Sample Findings

CONTROLS OVER CASH DISBURSEMENTS (2018-01)

Condition

During our audit, Wipfli noted thirteen (13) checks that were presented to the bank for clearing that had not been signed by an authorized check signer of The NPO. This happened on four separate occasions and was not a one-time incident. During our audit, we also discovered six (6) checks that were presented to the bank for clearing that had been hand written and not processed thru the accounting software.

This was done twice during the year. In addition, we also discovered a check that appears clearly to have a forged signature, although the check was processed thru the accounting software, was approved for payment and has what appears to be a valid invoice.

Sample Findings

EXPENSE ACCRUALS (2018-02)

Condition

During our audit, Wipfli discovered The NPO does not accrue expenses to the appropriate fiscal period; items are expensed when paid. The financial statements are materially correct as adjusting journal entries were posted to remedy the deficiency. The finding did not affect any completed grants during the year; however, the lack of expense accrual affected the monthly grant reporting process at year-end.
ACCESS RIGHTS IN THE ACCOUNTING SOFTWARE (2018-02)

Condition

During the audit, we reviewed the internal controls surrounding access rights in the accounting software. We noted that all accounting staff had access to post journal entries in the general ledger. User access and authorization rights within the general ledger software to initiate and post journal entries should be commensurate with an employee’s job function and title. Since access rights specific to each employee’s job function is not limited, a significant deficiency in internal controls exists.

GRANT REPORTING AND CASH MANAGEMENT (2018-02)

Condition

The final Financial Status Report filed with DHHS for the Head Start grant ending July 31, 2017 was obtained to determine if the total federal expenses reported were supported by the general ledger. Upon examination of The NPO’s Head Start expenses recorded for the above grant, it was noted that $4,268,473 in federal expenses were recorded in the general ledger, while The NPO reported, and received reimbursement for, total federal expenses of $4,285,607.
Sample Findings

INTERNAL CONTROL OVER COMPLIANCE WITH IN-KIND REGULATIONS DEPARTMENT OF HEALTH AND HUMAN SERVICES, HEAD START, (2018-01)

Condition

During the audit, we noted several instances where internal control over reporting of in-kind by The NPO was deficient.

- Some forms were missing parent or staff signatures
- There were some forms with photocopied donor signatures
- Teachers were dating forms as reviewed prior to the dates volunteers provided the service

Sample Findings

ACCOUNT BALANCE ADJUSTMENTS AND FINANCIAL STATEMENT PREPARATION (2018-01)

Condition

During the audit, Wipfli LLP proposed several adjusting journal entries for grant revenue, grant expense, grants receivable, and property and equipment which we deem to be material in relation to the financial statements. In addition, an organization's internal control over financial reporting does not end at the general ledger, but extends to the preparation of the financial statements and notes.

As part of our professional services for the year ended December 31, 2017, Wipfli LLP made significant adjustments to the financial statements and related footnotes. Since The NPO's internal controls did not discover the adjustments prior to our audit, and management relies on Wipfli LLP to provide the necessary understanding of current accounting and disclosure principles in the preparation of the financial statements, a material weakness exists in The NPO's internal controls over these areas.
ALLOWABLE COSTS/COST PRINCIPLES – COST ALLOCATION (2018-02)

Condition

During the audit, Wipfli LLP discovered an error in the allocation of shared administrative costs between Head Start and the Child Care Program. The error was corrected by The NPO’s management. Since The NPO’s internal controls did not prevent, or detect and correct, the error in cost allocation, a significant deficiency in internal controls exists.

SEGREGATION OF DUTIES (2018-02)

Condition

Management of The NPO consists of only the Executive Director who performs all functions of the organization.
Management Comment, Significant Deficiency, or Material Weakness?

Case Study

Segregation of Duties

- The organization has a single accountant handling the day to day operations. This individual handles collections, billings, and general ledger maintenance.
- How would you report this?
  - Management Comment
  - Significant Deficiency
  - Material Weakness
Lack of Segregation of Duties could be reported as:

- **Management comment**
  - The auditor has discussed this with management.
  - The effects of this finding are not material to the financial statements, there are compensating controls.

- **Significant Deficiency**
  - The auditor has disclosed this in the Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on Audit of Financial Statements Performed in Accordance With Government Auditing Standards and on the Schedule of Findings and Questioned Costs.
  - The auditor has discussed with management and management and the auditor have agreed that the compensating controls in place do not mitigate the risk to an acceptable level.

- **Material Weakness**
  - The auditor has disclosed this in the Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on Audit of Financial Statements Performed in Accordance With Government Auditing Standards and on the Schedule of Findings and Questioned Costs.
  - The auditor has discussed with management and management and the auditor have agreed that there are no compensating controls and the financial statements are at risk to be materially misstated.

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How will we respond to the auditor?

- **Why the lack of segregation of duties**
  - Cost benefit of hiring additional staff
  - Compensating controls
Preparing your Response and Corrective Action Plan

- Preparing responses to auditor findings
  - Discuss with the auditor what their findings are and make sure you have a clear understanding.
  - Determine if there are compensating controls or other means that mitigate their finding.
  - Draft a response to the finding and the corrective action plan (Single Audit Entities).

Corrective Action Plan

- Preparing Corrective Action Plan under Uniform Guidance
  - Reference the finding number from the auditor’s schedule of findings and questioned costs.
  - The corrective action to be taken.
  - Identify the specific individuals to implement the plan.
  - Identify the anticipated date for the action to be completed.
FASB Modifies Not-for-Profit Financial Reporting Rules

The standard update is designed to help not-for-profits tell their story through their financial statements.

- Improve relevance, transparency, and comparability
- Simplification
- More information and better clarification
  Organization resources (including usage and restriction)

Current guidance has been in effect since 1993.
FASB Modifies Not-for-Profit Financial Reporting Rules

**Key Phase I Changes:**
- Improving presentation and disclosures for net asset classes (net asset classification)
- Allowing choice of using direct OR indirect method in presenting cash flows
- Enhancing information about the liquidity and availability of financial resources
- Providing better information about expenses and expense allocation
- Improving reporting of investment return
Net Asset Classification

Current GAAP
- Unrestricted
- Temp. Restricted
- Perm. Restricted

Revised GAAP
- Without Donor Restrictions*
- With Donor Restrictions*

Disclosures
- Amount, purpose, and type of board designations **
- Nature and amount of donor restrictions

*NFP’s may choose to disaggregate further
**New disclosure requirement

Net Asset Classification – Statement of Financial Position

Current GAAP:

Net assets:
- Unrestricted: 6,795,083 6,503,076
  - Undesignated: 2,150,001 2,123,568
  - Designated by the governing board: 4,645,082 4,379,508

Temporarily restricted: 73,253 100,194
Permanently restricted: 236,000 236,000

Total unrestricted: 8,045,384 8,626,384
Total net assets: 9,252,335 8,962,778

TOTAL LIABILITIES AND NET ASSETS: $9,681,580 $9,437,999

NEW GAAP:

Net assets:
- Without donor restriction: 6,795,083 6,503,076
  - Undesignated: 6,795,083 6,503,076
  - Designated by the governing board: 2,150,001 2,123,568

Temporarily restricted: 73,253 100,194
Permanently restricted: 307,194 310,194

Total without donor restriction: 8,945,084 8,826,384
Total with donor restriction: 9,252,335 8,962,778

TOTAL LIABILITIES AND NET ASSETS: $9,861,580 $9,437,999
### Net Asset Classification – Disclosures

**Amount, Purpose, and Type of Board Designations**
- Can be on the face
- In the footnotes

  **Examples:**
  - Quasi-endowments
  - Future expenditures
  - Capital needs

**Nature and Amount of Donor Restrictions**
- Can be on the face
- In the footnotes

  **Examples:**
  - Assets with stipulations for preservation (works of art or land)
  - Assets to be invested (endowments)
  - Support of particular activities
  - Use in a specified future period
  - Acquisition of long-lived assets

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**Net Asset Classification - Disclosures**

<table>
<thead>
<tr>
<th>Net assets:</th>
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<tbody>
<tr>
<td>Without donor restriction:</td>
</tr>
<tr>
<td>Undesignated</td>
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<tr>
<td>Designated by the governing board</td>
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<tr>
<td>Total without donor restriction</td>
</tr>
<tr>
<td>With donor restriction</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
</tr>
</tbody>
</table>

**TOTAL LIABILITIES AND NET ASSETS** | 5,661,530 | 9,637,999 |

This presentation would require expanded footnote disclosure

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**One step further:**

<table>
<thead>
<tr>
<th>Net assets:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Without donor restriction:</td>
</tr>
<tr>
<td>Undesignated</td>
</tr>
<tr>
<td>Designated by the board for capital needs</td>
</tr>
<tr>
<td>Total without donor restriction</td>
</tr>
<tr>
<td>With donor restriction</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
</tr>
</tbody>
</table>

**TOTAL LIABILITIES AND NET ASSETS** | 9,252,335 | 8,972,778 |
Net Asset Classification – Expiration of Capital Restrictions

Change: Requires “placed in service” method for releasing from restriction (*no more implied time restrictions*)

Most common application for GF NFP’s? *Grant Funded Equipment*

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Net Asset Classification – Expiration of Capital Restrictions

Common footnote disclosure under current GAAP for GFE:

Property and Equipment

Property and equipment are capitalized at cost. Depreciation is provided for using the straight-line method over the estimated useful life of the asset. The Organizations consider items with a cost greater than $5,000 and a useful life greater than one year to be equipment and vehicles.

Property and equipment purchased with grant funds are owned by the Organizations while used in the program for which they were purchased or in other future authorized programs. However, the various funding sources have a reversionary interest in the property and equipment purchased with grant funds. Their disposition, as well as the ownership of any proceeds therefrom, is subject to funding source regulations. The property and equipment purchased with grant funds are normally restricted for use in specific programs operated by the Organizations. The net book value of grant-funded equipment included on the consolidated statement of financial position is $80,458 at September 30, 2018.

The Organizations have adopted a policy of implying a time restriction on assets purchased with grant funds. Grant-funded property and equipment are recorded at temporarily restricted net assets. As the property and equipment are depreciated, the temporarily restricted net assets are released from restriction and reported in the consolidated statement of activities as net assets released from restriction.
Net Asset Classification – Expiration of Capital Restrictions

Example footnote disclosure under NEW GAAP:

The Organization reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash and other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Liquidity and Availability of Resources

**Qualitative** Information:

What: How does the NFP manage its liquid available resources and its liquidity risk?

Where: Footnotes

**Quantitative** Information:

What: How are the NFP’s assets available at the statement of financial position date to meet cash needs for general expenditures within one year

Where: Either on the face and/or the footnotes
Liquidity and Availability of Resources

**Qualitative Information Example:**
The Organization maintains cash and cash equivalents on hand to represent approximately 6 months of general operating expenditures. These balances are held in liquid bank accounts or other securities or investments with maturities of 3 months or less.

**Quantitative Information Example:**

\[
\begin{array}{c|c}
\text{Financial assets, all payables and} & 9,224,412 \\
\text{Less: those available unrestricted for general expenditures} & \\
\text{Restricted by donor with time or purpose restrictions} & (11,040) \\
\text{Subject to appropriation and satisfaction of donor restrictions} & (144,206) \\
\text{Investments held to accumulate investment income} & 16,056 \\
\text{Amounts held by board members} & (30,250) \\
\text{Less: dispositions:} & \\
\text{Cash investment income, primarily for long-term investing} & (36,530) \\
\text{Amounts available for liquidity reserve} & (1,500) \\
\text{Financial resources available to meet cash needs for general expenditures in one year} & 3,207 \\
\end{array}
\]

Expenses and Expense Allocation

Change: **Required now** to report expenses either on the face of the financials OR in the footnotes by:

- Function*
- Natural Classification
- Analysis (disaggregate function by nature)**

The standard also provides enhanced guidance on allocations from M&G expenses
  - key concept: *direct conduct* or *direct supervision*

* currently required in GAAP
**choice of location; FASB may explore segment reporting instead for HC in Phase II
Expenses and Expense Allocation

NFP’s also required to provide qualitative disclosures about methods used to allocate costs among program and support functions

Example Qualitative Disclosure:

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president’s office, communications department, and information technology department. Depreciation is allocated based on square footage, the president’s office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.
Implementation Strategy – START EARLY

- Review and understand early so you’re not scrambling when the time comes for implementation. As discussed several presentation options to meet the requirements
- Utilize others outside of fiscal (development, etc.) in information gathering

Implementation Strategy – COLLABORATION

Discuss with your auditors

- Discuss early implementation if it’s something you’re interested in
- Ask your auditors if they have a toolkit or information gathering tool they’d like you to use
- If you prepare your financial statement draft, work collaboratively to ensure you don’t miss anything significant to avoid findings
- Even if you don’t prepare your financial statement draft, talk with your auditors so that they know you understand what’s required
Implementation Strategy – EXAMPLES

Toolkit

- Wipfli is in the process of developing one, other firms probably have something similar
- Lays out the information necessary to complete the changes to the financial presentation that are required

Examples will continue to be developed by the AICPA, the FASB, and practitioners.

Implementation Strategy – ENGAGE YOUR BOARD

Discuss with board committees responsible for financial reporting oversight prior to final implementation.

Consider drafting disclosures for review and approval by your committee prior to audit fieldwork.
Implementation Strategy

There shouldn’t be a need to change internal processes/procedures – will mostly be data gathering and presentation*

*Exception could be accounting for underwater endowment balances

Timing for Implementation
Get Ready Early

Effective date for implementation:
For fiscal years beginning after December 15, 2017
(essentially fiscal years ending December 31, 2018 and after)

Early Adoption: permitted, but must apply the regular transition provisions.

Transition:
- For year of adoption: apply all provisions
- For comparative years presented: apply all provisions, except can choose not to present:
  - Analysis of expenses by nature and function*
  - Disclosures around liquidity and availability of resources
* unless already required to do so under current GAAP

Other important notes:
- NFP’s are already permitted to incorporate many of the changes required (e.g. netting investment expenses, presenting expenses by nature and function, using placed in service approach, etc.)
- The only changes that cannot be implemented without formal adoption of the standard are:
  - Changing the net asset classification
  - Change classification of underwater endowment net assets
  - Eliminating net investment expenses disclosure
  - Eliminating requirement to present indirect reconciliation if direct method of cash flow reporting is used
Evaluation!

Please turn in your evaluation as you leave. We love your feedback!

Thank You!

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