The webcast will start at 1:00 p.m. Eastern

- Visit capincrouse.com/DFMC-accounting-webcast to access these materials from today's webcast:
  - Handout
  - Recording
- If you qualify for CPE credit, a certificate will be emailed to you within the next few weeks

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Learning Objectives

- Post-implementation review of recent standards
- Overview of the CECL model and changes affecting our clients
- Accounting for and disclosure of crypto assets
- Summary of the FASB current technical agenda and research projects

FASB Post-Implementation Review

- To determine whether a standard is accomplishing its stated purpose
- To evaluate the standard's implementation and continuing compliance costs and related benefits
- To provide feedback to improve the standard-setting process

Polling Question 1

Do you want CPE credit?

- Yes
- No

Leases: Post-Adoption

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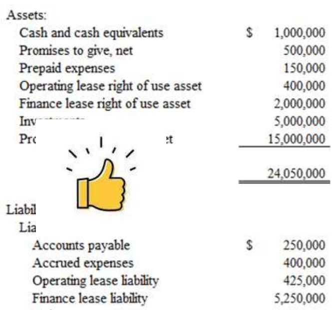
Some Feedback Received by FASB – Leases

- Larger NFPs/organizations with many leases generally use lease software; others generally use Excel
- Efficiencies realized from documenting all leases in a single system
- For some NFPs that are more decentralized, capturing all of the pertinent agreements was a challenge
- Determining discount rate was a significant discussion area, but most went with the risk-free rate

Some Feedback Received by FASB – Leases

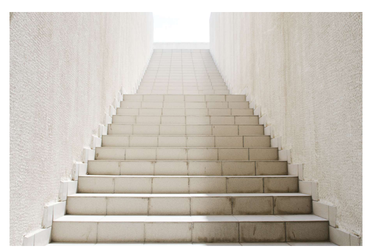
- The operating lease liability and related note disclosure provide more decision-useful information than the operating lease commitments disclosed under the previous guidance



Assets:		
Cash and cash equivalents	$	1,000,000
Promises to give, net		500,000
Prepaid expenses		150,000
Operating lease right of use asset		400,000
Finance lease right of use asset		2,000,000
Inv		5,000,000
Pr[illegible]t		15,000,000
		24,050,000
Liabil		
Lia		
Accounts payable	$	250,000
Accrued expenses		400,000
Operating lease liability		425,000
Finance lease liability		5,250,000

- Users continue to analyze operating leases separately from finance leases
- Some adjustments have been made to borrower's debt covenants, but overall did not materially impact the analysis of core metrics

Some Feedback Received by FASB – Leases



- Some of the more challenging areas faced are:
  - Lease modifications
  - Sale and leaseback arrangements
  - Applying impairment guidance to right-of-use (ROU) assets
  - Common control arrangements (related-party leases)

Lease Modifications

Definition

- Lease modifications defined
  - A change in the terms and conditions of a contract that results in a change in the scope of or consideration for the lease
  - Example: Change in the lease term or change in the number of underlying assets within the lease

A lease modification can result in…	
A separate contract	A change in the accounting for the existing lease

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Lease Modifications

Separate Contract

- A lease modification results in a separate contract when **both** of the following are met —
  - The modification grants the lessee the right-to-use an additional asset that is not included in the original lease; and
  - The lease payments increase commensurate with the standalone price for the additional right-of-use asset

**If only one of these exist, it isn't a separate contract.*

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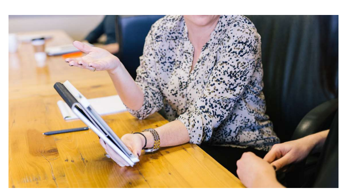
Lease Modifications
Separate Contract

- If you have a lease modification that results in a separate contract, then you account for **two** separate contracts:
  - The unmodified original contract
  - A separate contract, which is accounted for the same as any other new lease

Example: Lease modification that adds a second copier. Additional cost of the new copier approximates that of the existing.

Lease Modifications
Doesn't Result in a Separate Contract

- When a lease modification **doesn't** result in a separate contract, then you:
  - Reassess the classification of the lease (operating vs. financing)
  - Reassess the measurement/allocation of consideration in the contract, including any lease payments based on an index or rate
  - Reassess the lease term and purchase options
  - Update the discount rate for the new factors



Lease Modifications

Triggers for Changes in Lease Terms / Exercising a Purchase Option

- Lessees are required to reassess the lease term (i.e., the likelihood of exercising a renewal or termination option) or whether it is reasonably certain that they will exercise an option to purchase the underlying asset **at the point in when any of the following occurs**:

Event	Description
Contractual Event	There is an event written into the contract that obliges the lessee to exercise or not to exercise the option to extend or terminate a lease.
Option Exercised	The lessee elects to exercise an option even though it had previously determined that it was not reasonably certain to do so.
Option Not Exercised	The lessee elects not to exercise an option even though it had previously determined that it was reasonably certain to do so.
Significant Event or Change in Circumstance	There is a significant event or change in circumstance **within the lessee's control** that directly affects whether the lessee is reasonably certain to 1) extend the lease; 2) not terminate the lease; or 3) purchase the underlying asset.

Lease Modifications

Triggers for Changes in Lease Terms / Exercising a Purchase Option

- Examples of significant changes or events in circumstances **within the lessee's control** include:
  - Constructing significant leasehold improvements that are expected to have significant economic value when the option becomes exercisable
  - Making significant modifications or customizations to the underlying asset
  - Making a business decision that is directly relevant to the lessee's ability to exercise or not exercise an option
  - Subleasing the underlying asset for a period beyond the exercise date of the option

Lease Modifications

Triggers for Changes in Lease Terms / Exercising a Purchase Option

- Question: Does the increase in market rents (which may increase the likelihood of the client staying in their leased office space longer) trigger a reassessment of the lease term?
- Answer: No! A change in market-based factors is not within the lessee’s control and therefore does not trigger a reassessment by itself.

Shouldn’t be flip-flopping on renewal option expectations!

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Lease Modifications

Changes in CPI

- How does a lease payment that is adjusted for the consumer price index (CPI) each year at the anniversary date get accounted for under ASC 842?
  - Variable lease payments that depend on an index or rate should <u>initially be measured</u> using the index or rate at commencement date.
  - Subsequent adjustments to the index or rate are treated as <u>variable lease payments</u> and recognized in the period in which the obligations for those payments were incurred.
  - Variable lease payments are to be disclosed in the FNs.

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Lease Modifications
Early Terminations

- A termination of a lease before the expiration of the lease term shall be accounted for by the lessee by removing the ROU asset and liability, with profit or loss recognized for the difference (ASC 842-20-40-1)
- Any consideration received or paid upon termination that was not already included in the lease payments is included in the gain/loss on termination of the lease

Lease Modifications
Early Terminations

- In year two of a five-year office lease, an organization purchased an office space and thereby terminated its existing lease. An early termination penalty of $5,000 was charged upon termination.
- Removal of the ROU asset and liability:

Account	Debit	Credit
ROU Liability	$25,000	
ROU Asset		$22,000
Cash		$ 5,000
Loss on Lease Termination	$ 2,000	

Update 2023-01 Leases: Common Control Arrangements (Related Parties)

1. Terms and conditions to be considered:

   - Use <u>written</u> terms and conditions to determine classification and accounting for the lease
   - Can be elected on an arrangement-by-arrangement basis
   - Applies to NFPs that are NOT obligors for publicly-traded conduit or other debt

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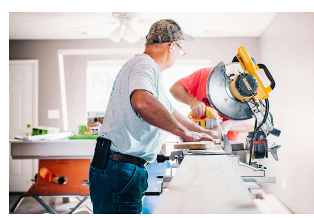
Update 2023-01 Leases: Common Control Arrangements (Related Parties)

2. Leasehold Improvements



   - Required to be amortized by the lessee over the useful life to the common control group as long as the lessee controls the use of the underlying leased asset
   - Accounted for as a net asset transfer between entities under common control if, and when, the lessee no longer controls the underlying asset

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Polling Question 2

For lease modifications that don't result in a separate contract, reassessment of which of following is required?

- Lease classification
- Discount rate
- Lease term and purchase options
- All of the above

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Revenue Recognition: Post-Adoption

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FASB Feedback – Revenue Recognition Challenges

- Standalone selling price
- Identification of performance obligations
- Licensing
- Variable consideration
- Disclosures

Five-Step Process to Revenue Recognition				
1	2	3	4	5
Identify the contract(s) with a customer	Identify the performance obligations in the contract	Determine the transaction price	Allocate the transaction price to the separate performance obligations	Recognize revenue when (or as) the entity satisfies a performance obligation

Post Implementation Review (PIR) report expected to be issued in 2024.

Current Expected Credit Loss (CECL) Model

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CECL
Background

- Current U.S. GAAP is based on the incurred loss model, which delays recognition of credit losses until it is *probable* the loss has been incurred
- ISSUE: What about events that have not yet occurred yet are expected and will have a significant impact on credit worthiness?
  - The global financial crisis of 2007 and 2008 highlighted the weakness of the incurred loss model approach
  - These credit losses were expected but did not yet meet the “probable” threshold

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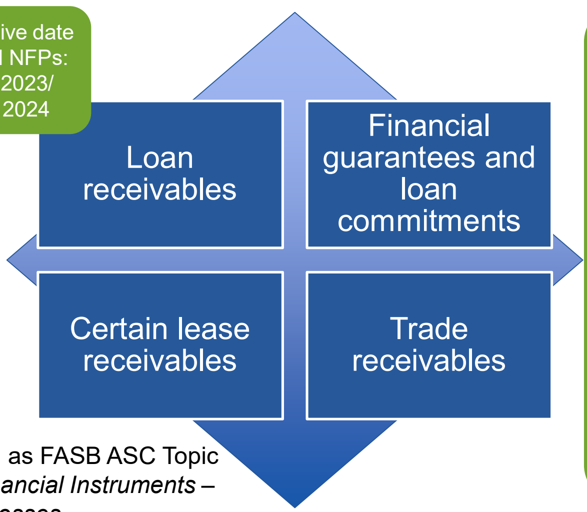
Current Expected Credit Losses (CECL)
Effective Date and Scope

Effective date for all NFPs: CY 2023/ FY 2024



Codified as FASB ASC Topic 326, *Financial Instruments – Credit Losses*

What’s **NOT** in Scope:
- Contributions receivable
- Grants receivable (when using contribution model)
- Loans between entities under common control
- Operating lease receivables

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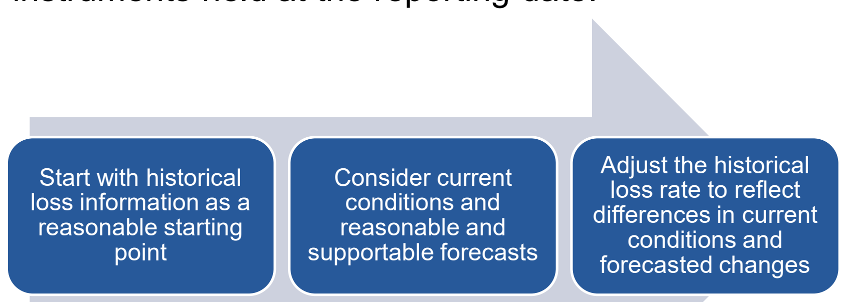
CECL
What's Changed?

Prior Incurred Loss Model	New Expected Loss Model (CECL)
Losses recorded when probable of being incurred	No threshold for recognition – all expected credit losses are recorded on Day 1, leading to more timely identification and recognition of future losses
If no indicators of loss, no reserve required	Allowance for credit losses is required even if the risk is remote
Based primarily on historical experience	Based on reasonable and supportable forecasts about total future credit losses, factoring in both historic and current data as well as forecasts of the future
Typically applied to past-due amounts for trade receivables	Must be applied to all balances, including those that are still current

CECL
Calculation Basics

- Record the expected lifetime credit losses for financial instruments held at the reporting date:



* *Revert to historical loss information when unable to make reasonable and supportable forecasts. The reversion method applied must be well documented and is not a policy election.*

CECL
Key Provisions

- May continue to determine allowance using existing methodology, such as aging schedules
- Pool assets that share similar risk characteristics together when measuring the allowance for credit losses
- When accounts do not share similar risk characteristics with other financial assets, they should be **evaluated** for credit loss **individually**

Examples of factors to consider for pooling trade receivables:

- Customer industry
- Product line
- Geographical location
- Receivable aging
- Terms
- Customer credit rating
- Size

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CECL
Reasonable and Supportable Forecasts

- Reasonable and Supportable Forecasts
  - Does not mean an entity is required to consider all sources of available information
  - Consider relevant information that is reasonably available and can be obtained without undue cost and effort
  - Can be internal or external information, or a combination

- Inflation considerations
- Recession considerations
- Unemployment rates

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Polling Question 3

Which of the following is NOT true about the CECL model?

- It may result in an allowance on current AR.
- It includes forecasted economic conditions in the estimate.
- It's an objective projection with no estimation required.
- Pool AR by similar risk factors to calculate the allowance.

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CECL
Example – Student A/R Using Historical Adjusted Aging

- ABC University believes historical information is a reasonable basis for estimating future losses. Historical rates are based on 5 years of analysis. The composition of student accounts receivable is consistent with the look-back period.
- Current and reasonable supportable forecasts show that the economic conditions affecting ABC's student population have worsened compared to historical conditions due to inflation and an expected upcoming recession.

- The loss rate is estimated to have increased by 10% in each aging bucket over the next fiscal year.

10% ↑

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CECL

Example – Student A/R Using Historical Adjusted Aging

Management applies these forecasts to create the following credit loss matrix to calculate the allowance for credit losses as of June 30, 2024:

Past-due Status	Amortized Cost Basis (a)	Historical Loss Rate % (b)	Adjustment to the Credit Loss Rate (b x 10% = c)	Expected Credit Loss Estimate (a x c)
Current	$1,000,000	0%	0.1%	$ 1,000
1-30	500,000	5%	5.5%	27,500
30-60	250,000	10%	11.0%	27,500
60-90	150,000	25%	27.5%	41,250
90-120	100,000	50%	55.0%	55,000
>120	50,000	75%	82.5%	41,250
Total	$2,050,000			$193,500

CECL

Example – Student A/R Using Historical Adjusted Aging

Assume a $100,000 allowance as of FY23 and a cumulative impact of $15,000 upon adoption of the new standard.

	Debit	Credit
Credit Loss Expense (SOA)	$78,500	
Allowance for expected credit losses (SFP)		$78,500

	Debit	Credit
Net Assets, Beginning of Year (SOA)	$15,000	
Allowance for expected credit losses (SFP)		$15,000

At each reporting period, the NFP should update its estimate of lifetime expected credit losses and adjust the allowance accordingly. **Increases and decreases** are **both** classified as **credit loss expense**.

CECL
Effective Date and Transition

- Effective for all organizations that have not yet adopted for years beginning after December 15, 2022 (CY 2023 and FY 2024)
- Modified-retrospective approach
  - An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach)

- Transition disclosures required

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CECL
Statement of Financial Position Presentation

- Allowance must be presented in one of two ways:
  - Deduction from the assets' amortized cost (i.e., separate line item)
  - Amount disclosed, but asset shown net (e.g., receivables, net of allowance of $XX)

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CECL
Statement of Financial Position Presentation

Separate line approach

	December 31, 2023	
Cash	$ 100,000	
Total cash		$ 100,000
Accounts receivable		
Accounts receivable - trade	25,000	
Accounts receivable - other	5,000	
Allowance for doubtful accounts	(7,250)	
Total accounts receivable		22,750

Net approach

	December 31, 2023
Cash	$ 100,000
Accounts receivable (net of allowance of $7,250)	22,750
Prepaid expenses	2,000
Property and equipment, net	150,000
Total Assets	$ 274,750

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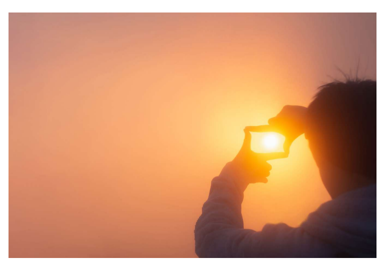
CECL
Disclosures

- Big picture — disclosures should enable a reader to understand the following:
  - The credit risk inherent in a portfolio and how management monitors the credit quality of a portfolio
  - Management's estimate of expected credit losses
  - Changes in the estimate of expected credit losses that have taken place during the period



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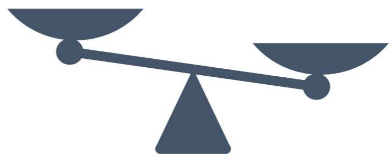
CECL
Disclosures

- Each entity needs to determine how much detail to provide based on its specific facts and circumstances

Too much aggregation – excludes important details

Too much disaggregation and details – obscures material information



Leaning too much in one direction or the other causes an imbalance.

CECL
Disclosures

- Required disclosures include:
  - A description of management's policy and methodology for developing the allowance for credit losses
  - A rollforward of the balance
  - An aging analysis of past-due loans*
  - Credit quality indicators*
  - Transition disclosures

These disclosures are made by portfolio segment.

*Disclosure of an aging analysis of past due loans and credit quality indicators are not required for trade receivables due in less than one year.

CECL

Disclosures – Transition Period

Recently Adopted Accounting Guidance

Allowance for Credit Losses

In June 2016, the FASB issued guidance (FASB ASC 326) which significantly changed how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The most significant change in this standard is a shift from the incurred loss model to the expected loss model. Under the standard, disclosures are required to provide users of the financial statements with useful information in analyzing an entity's exposure to credit risk and the measurement of credit losses. Financial assets held by ABC University that are subject to the guidance in FASB ASC 326 are student accounts receivable.

CECL

Disclosures – Transition Period

Recently Adopted Accounting Guidance, continued

Allowance for Credit Losses, continued

[If adoption is material]

ABC University adopted the standard effective July 1, 2023, utilizing a cumulative-effect adjustment for all financial assets measured at amortized cost. As a result of the adoption, ABC University recorded a transition adjustment, which included an $15,000 increase to the allowance for credit losses for student accounts receivable, which is presented on the statement of financial position as a reduction to the total amount of student accounts receivable. In addition, the transition adjustment resulted in an increase of $15,000 to beginning net assets as of July 1, 2023, which represents the cumulative effect of adopting FASB ASC 326.

[If adoption is immaterial]

ABC University adopted the standard effective July 1, 2023. The impact of the adoption was not considered material to the financial statements and primarily resulted in enhanced disclosures only.

CECL
Disclosures – General Policy

Student accounts receivable consists of amounts billed to students for tuition and auxiliary charges. Student accounts receivable are presented net of an allowance for credit losses, which is an estimate of amounts that may not be collectible. ABC University separates accounts receivable into risk pools based on their aging. In determining the amount of the allowance as of the statements of financial position date, ABC develops a loss rate for each risk pool. The loss rate is based on management's historical collection experience, adjusted for management's expectations about current and future economic conditions. As of June 30, 2024, ABC University increased its historical loss rate for each aging category by 10% due to rising inflation and indicators of a potential recession.

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CECL
Disclosures

Changes in the allowance for credit losses for the year ended June 30, 2024, are as follows:

	Year Ended June 30, 2024
Balance, beginning of year	$100,000
Impact of the adoption of the new credit loss standard*	15,000
Provisions	80,000
Write-offs, net of recoveries	(1,500)
Balance, end of year	$193,500

*In the year of adoption, the rollforward must include the impact of adoption (recognized as a cumulative effect adjustment at the beginning of the period).

*ONLY required if the allowance is deemed material

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Polling Question 4

An organization is only required to disclose the CECL allowance in the notes to the financial statements.

- True
- False

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Accounting for Crypto Assets

ASU 2023-08 Intangibles – Goodwill and Other – Crypto Assets

- Requires all entities to measure **certain** crypto assets they hold at fair value and to reflect changes from the remeasurement of those assets in change in net assets each reporting period

- Replaces the former accounting model of recording at current cost less impairment

- Effective for fiscal years beginning after December 15, 2024, with early adoption permitted

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ASU 2023-08 Intangibles – Goodwill and Other – Crypto Assets

Applies to crypto assets that meet all of these criteria:

- Meet the definition of an intangible asset
- Do not provide the asset holder with enforceable rights to, or claims on, underlying goods, services, or other assets
- Are created or reside in a distributed ledger based on blockchain or similar technology
- Are secured through cryptography
- Are fungible
- Are not created or issued by the reporting entity or its related parties

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ASU 2023-08 Intangibles – Goodwill and Other – Crypto Assets

- Requires that crypto assets measured at fair value be shown separately from other intangible assets on the statement of financial position and also the changes from remeasurement separately from changes of other intangibles on the statement of activities
- When the entity converts crypto assets nearly immediately into cash, it is required to classify those cash receipts as cash flows from operating activities

- Required disclosures on the types of crypto assets held and changes in those holdings

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FASB Technical Agenda

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FASB's Technical Agenda Overview

Recognition & Measurement Projects	Next Milestone	Expected Date
Accounting for and Disclosure of Software Costs	Board deliberations	Ongoing
Accounting for Environmental Credit Programs	Board deliberations	Ongoing
Accounting for Government Grants	Board deliberations	Ongoing
Codification improvements (next phase)	Board deliberations	Ongoing
Codification improvements (remove reference to Concepts Statements)	Final ASU	1Q 2024
Financial Instruments-Credit Losses-Purchased Financial Assets	Board re-deliberations	Ongoing
Induced Conversions of Convertible Debt Instruments	Exposure Draft	Comments Due March 18, 2024
Scope Application of Profits Interest Awards: Compensation-Stock Compensation (Topic 718)	Final ASU	1Q 2024
Topic 815-Derivatives Scope Refinements	Board deliberations	Ongoing
Topic 815-Hedge Accounting Improvements	Board deliberations	Ongoing

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FASB's Technical Agenda Overview (continued)

Presentation & Disclosure Projects	Next Milestone	Expected Date
Disaggregation-Income Statement Expenses	Board re-deliberations	Ongoing
Interim Reporting-Narrow-Scope Improvements	Exposure Draft	2Q 2024
Statement of Cash Flows Targeted Improvements	Board deliberations	Ongoing

Framework Projects	Next Milestone	Expected Date
Conceptual Framework: Measurement	Exposure Draft	Comments Due March 20, 2024

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FASB's Technical Agenda Overview (continued)

Research Projects
Accounting for and Disclosure of Intangibles
Accounting for Commodities
Consolidation of Business Entities
Definition of a Derivative
Financial Key Performance Indicators for Business Entities
Statement of Cash Flows

Post-Implementation Projects
Credit Losses
Leases
Revenue Recognition

Accounting for and Disclosure of Software Costs – Project Scope and Objective

Software Costs

- Costs incurred to develop or purchase software that is solely for entity's internal use
- Costs incurred to develop a hosting arrangement platform
- Costs incurred by a customer to implement a cloud computing arrangement

Subtopic 350-40

- Costs incurred to develop software to be sold or licensed to customers
- Costs incurred to develop software used in a hosting arrangement in which the customer can take possession

Subtopic 985-20

Objectives:
- To modernize the accounting for software costs
- To enhance the transparency about an entity's software costs

Responding to Suspicions of Fraud

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Fraud Can Occur in Any Organization

- Many churches and other nonprofits expect fraud will never happen to them and are caught off-guard when it does
- Fundamentally, fraud is a symptom of the fallen human heart, so all ministries are exposed to the risk
- Even Jesus's ministry was a victim of fraud (John 12:1-6)
- Acknowledging this predicament is the first step to reducing the risks of fraud
  - Develop ways to prevent fraud
  - Develop a plan to respond if your organization should ever become a victim

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Steps to Take When Fraud Is Suspected

- Notify the appropriate leadership parties in your organization
  - If you have a formal whistleblower hotline and fraud response process, use it
- Consult with your organization's attorney to ensure actions taken in response to allegations or suspicions are in line with legal guidelines
- Determine the possible outcomes of a fraud investigation — termination of employee, fidelity bond claim, legal action, or a combination of these
  - To provide an objective starting point, leadership should consider possible outcomes before an allegation of fraud ever occurs

Steps to Take When Fraud Is Suspected (continued)

- Discreetly place the suspected employee on leave and limit his or her access to assets and systems
- Develop a plan to investigate the issue based on the sophistication, scope, and estimated amount of the suspected fraud
  - Consider engaging a forensic investigator
- Execute and stick to the plan
- Gather essential facts about the suspicions or allegations

Steps to Take When Fraud Is Suspected (continued)

- Plan and conduct interviews with individuals deemed to have information helpful to the investigation (possibly the suspect, other employees, witnesses, etc.)
- Secure all items of evidence (electronic and hard copy) and maintain a chain of custody in case legal action transpires
- If the suspect has confessed to fraud or irrefutable evidence is obtained regarding the suspect, remove the suspect's access to your accounting system and assets
  - Change passwords and locks, collect keys, remove check-signing authority and access to bank accounts, etc.

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Steps to Take When Fraud Is Suspected (continued)

- Based on the results of the investigation, determine what action is appropriate to take against the suspect, giving consideration to established organizational policies and all parties involved
- Consider what improvements can be made to the organization's internal controls based on the findings of the investigation
- Develop and execute a plan of communication with key stakeholders, as appropriate based on the findings of the investigation

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Questions to Ask When Fraud Is Suspected

- Who among your staff or membership knows of the suspicions or allegations? Who on the leadership team or board should be notified?
- Who will investigate the suspicious activity and follow up on allegations?
- What are your policies and what outcomes may come from an investigation — termination of employee, fidelity bond claim, legal action, or a combination of these?

Questions to Ask When Fraud Is Suspected (continued)

- What transactions are suspicious, or what assets are missing?
- Who has, or had, access to the assets and the accounting system?
- What access does, or did, the suspect have to assets and systems?

Questions to Ask When Fraud Is Suspected (continued)

- Who is the suspect? Is there more than one?
- Has anyone confessed to committing fraud?
- Are any of the suspects known to be experiencing personal financial difficulties that would provide motivation, such as high debt, bankruptcy, divorce, etc.?
- Have there been any observable behavioral or lifestyle changes among the suspects (addictions, living beyond means, a new car, expensive vacations or home improvements, etc.)?

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Questions to Ask When Fraud Is Suspected (continued)

- What are the possible ways the suspect could have committed fraud?
- How long has the suspect been employed at the organization?
- What is the time period under suspicion?
- Have there been varying levels of access to assets and systems during that time, or have they been the same throughout?

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Questions to Ask When Fraud Is Suspected (continued)

- Are there any checks and balances in place at the organization that would limit the amount of possible fraud committed?
- Can you estimate how much cash or how many assets were stolen?

Final Thoughts

- Fraud not only causes financial damage but threatens severe relational and reputational damage, depending on how well leadership responds
- A balance of wisdom, transparency, and decisiveness is needed
- While you may expect that fraud will never happen in your organization, you are most likely to respond appropriately and proactively if you develop a planned response you can use if it does

Thank you.

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