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WASHINGTON CONVENTION CENTER

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Thank you for joining us!

The presentation will begin shortly

Happy Halloween!!

Presenters

Meet the instructors

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Partner

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Manager

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Is Your Nonprofit Ready for the Implementation of the Current Expected Credit Losses (CECL) and Crypto Assets Accounting Standard Updates?

Tuesday, October 31, 2023

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Current Expected Credit Losses (CECL)

Current Expected Credit Losses

ASC Topic 326

- Accounting Standards Update (ASU) 2016-13: *Financial Instruments - Credit Losses (Topic 326)* implementation starts with fiscal years ending December 31, 2023, but the adoption date was January 1, 2023.
- ASU 2016-13 is also known as Current Expected Credit Losses (CECL), and it is not just for banks and for-profit companies. Nonprofits are included in this new standard.
- While the new standard does not apply to contributions, it does apply to programmatic loans and receivables related to exchange transaction revenues that fall under ASC Topic 606.
- Under the old standard, nonprofits recorded an allowance for doubtful accounts based on past experience that represents actual collections or lack thereof.
- CECL removes the probable threshold used in the old incurred loss method and requires recognition of credit losses when such losses are "expected."

This presentation summarizes the new standard. Please refer to ASC Topic 326 for details.

Polling Question #1

Knowledge test: what is included IN the scope of the new CECL standard?

A. *Contributions receivable (under ASC 958)*

B. *Operating lease receivable*

C. *Accounts receivable (under ASC 606)*

D. *Amounts due from related entities*

What's IN CECL's Scope

Financial assets IN scope include the following:

- Accounts receivable related to exchange transactions under ASC Topic 606.
- Notes or loans receivable with unrelated entities.
- Off balance sheet credit exposure, such as guarantees, commitments or letters of credit (i.e., entity is the recipient of potential assets).
- Assets related to financing leases held by the lessor.
- Any other financial asset not scoped out where the organization has the right to receive cash.

What's OUT of CECL's Scope

Financial assets OUT of scope include the following:

- Financial assets reported at fair value, such as investments (covered under ASC Topic 820).
- Participant loans receivable reported by a defined contribution plan.
- Contributions receivable (covered under ASC Topic 958).
- Intercompany notes or receivables, including notes or receivables between entities under common control.
- Derivatives and hedging instruments (covered under ASC Topic 815).
- Receivables related to operating leases held by the lessor.

Implementation Date Accounting

On January 1, 2023 (Day 1), what do you need to do?

1. Determine which financial statement lines (or disclosures) are required to have an allowance for credit losses (ACL).

2. Create an ACL account in your chart of accounts. This new account will be used instead of the allowance for doubtful accounts.

3. Calculate the ACL as of January 1, 2023, using guidance in the accounting standard (ASC Topic 326).

4. Recognize a cumulative-effect adjustment for the ACL in net assets as of January 1, 2023. If the ACL on January 1, 2023, is not material, you may want to discuss not recording the adjustment with your auditors. However, the adjustment should be recorded as of December 31, 2023.

5. If there was an allowance account before the adoption of CECL, the cumulative-effect adjustment on January 1, 2023, will be the difference between the old allowance for doubtful accounts and the new ACL.

Components of the ACL

The ACL should be based on historical loss experience +/- current conditions +/- a forecast of future conditions. All nonprofits will now need to determine expected losses rather than incurred losses. CECL requires an expected loss to be recorded upon origination of the asset.

Historical loss experience

- Assets should be pooled together if they exhibit similar risk characteristics.
- Document the review of prior year data to provide information on historical losses for each type of asset.

Current conditions

- Review qualitative and quantitative factors of current economic conditions to determine if adjustments should be made to the historical loss experience.
- Document the review of current conditions.

Future conditions

- Use a reasonable and supportable forecast period.
- Document the rationale and provide evidence supporting the reliability and accuracy of economic scenarios and forecasts of future conditions.

Potential Ways to Calculate the ACL

- **Loss-rate (aging) method**
- **Discounted cash flows model**
- *Vintage analysis*
- *Probability of default / loss given default*
- *Provision Matrix*
- *Regression Analysis*

Loss-rate (aging) method is good for accounts receivable related to ASC 606 revenue streams.

Discounted cash flows model is good for long-term notes receivable (or programmatic loans).

Most of the other ways to calculate the ACL are used by financial institutions for their loan portfolios. You are welcome to research these on your own, but we will focus on the first two methods as these are most likely what nonprofits will use.

Loss-Rate (Aging) Method

Customer	Balance	Current	31-60	61-90	>91
Entity A	$ 100,000	$ 75,000	$ 25,000	$ -	$ -
Entity B	200,000	50,000	50,000	50,000	50,000
Entity C	300,000	100,000	100,000	100,000	-
Gross Receivables	600,000	225,000	175,000	150,000	50,000
Less ACL	(133,125)	(7,875)	(19,250)	(64,500)	(41,500)
Net Receivables	**$ 466,875**	**$ 217,125**	**$ 155,750**	**$ 85,500**	**$ 8,500**

		Current	31-60	61-90	>91
Historical loss rates <		0.5%	8.0%	40.0%	80.0%
Current conditions ^		5.0%	5.0%	5.0%	5.0%
Future conditions >		-2.0%	-2.0%	-2.0%	-2.0%
		3.5%	11.0%	43.0%	83.0%

< Historical loss rates are based on the average of actual losses in each category over the past 10 years.

^ Upward adjustment for current conditions because the industry in which customers operate is experiencing challenges.

> Downward adjustment for future conditions because it is expected that the industry will rebound in the next year.

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Discounted Cash Flows Model

Customer	Loan Balance	Contractual Payments Due after Year End Year 1	Year 2	Year 3	Year 4	Year 5
Loan A (Prime + .25%)	75,000	15,000	15,000	15,000	15,000	15,000

Contractual payments should be adjusted before discounting to convert contractual cash flows to expected cash flows.
Three different expected payment scenarios follow:

Customer	Total Adjustments	Adjustments to Payments Due after Year End Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
1) Prepayment	-	7,500	3,750	3,750	-	(15,000)	-	-
2) Default	(15,000)	-	-	-	-	(15,000)	-	-
3) Recovery delay	-	-	-	-	-	-	15,000	15,000

Customer	Adjusted Balance	Expected Payments Due after Year End Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
1) Prepayment	75,000	22,500	18,750	18,750	15,000	-	-	-
2) Default	60,000	15,000	15,000	15,000	15,000	-	-	-
3) Recovery delay	75,000	15,000	15,000	15,000	-	-	15,000	15,000

Discounted Cash Flows Model (Continued)

The discount rate is equal to the effective interest rate (contractual borrowing rate adjusted for any fees or costs existing at origination of the loan). If the contractual rate varies based on Prime or SOFR, the ACL will change each time it's calculated as the rate changes over the life of the asset.

Prime plus .25%	7.75%
Fees at origination	0.05%
Discount rate	7.80%

Based on historical experience with Loan A, current economic conditions and a forecast of future conditions, determine which ACL makes the most sense.

	Prepayment	Default	Recovery Delay
Net Present Value	$ 63,081.64	$ 49,903.88	$ 57,221.30
Discount (ACL)	**(11,918.36)**	**(25,096.12)**	**(17,778.70)**

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Polling Question #2

CECL is an estimate made by management that is very subjective because it is based on the facts and circumstances of a nonprofit's business and customer base.

A. True

B. False

CECL Disclosure Requirements

- CECL disclosures should enable financial statement users to understand the following:
  a. credit risk inherent in a portfolio and how credit quality is monitored,
  b. methodology used to estimate the ACL, and
  c. period-over-period changes in the estimation of the ACL.
- The disclosure requirements under the new CECL standard are principles-based and give entities flexibility to determine the nature and extent of the information to be disclosed.
- The accounting policy in the first footnote to the financial statements will need to include information related to the requirements from items a. and b. from above.
- The related asset footnote should include a rollforward chart for the ACL to satisfy the requirement from item c. from above.

Accounting Policy Disclosures

Accounts receivable: Accounts receivable primarily consists of amounts due within one year related to the sales of publications, products, advertising, and meeting registrations. Accounts receivable are presented net of an allowance for credit losses resulting from the inability of customers to make required payments. The allowance for credit losses is based upon historical loss experience in combination with current economic conditions and a forecast of future economic conditions. Any change in the assumptions used in analyzing a specific account receivable might result in an additional allowance for credit losses being recognized in the period in which the change occurs. However, the Organization has historically had insignificant write-offs due to bad debts.

Notes receivable: Notes receivable consists of long-term unsecured programmatic loans to other nonprofit organizations (debtors). The loans have various origination dates and maturity dates and are typically repaid over ten years. Notes receivable are presented net of an allowance for credit losses resulting from the inability of debtors to make required payments. The Organization reviews the credit quality of each debtor on a quarterly basis. The Organization uses consumer credit risk scores in conjunction with internal credit risk grades based on collection experience in combination with current economic conditions and a forecast of future economic conditions to determine credit quality. The allowance for credit losses is based upon a discounted cash flows model using the contractual effective interest rate applied to the expected payments, which equal contractual payments adjusted for prepayment rates, probability of default, loss given default, and recovery delay.

These are sample footnotes and should be adjusted to fit your circumstances.

ACL Roll Forward Disclosure

		12/31/2023
Allowance for credit losses, beginning of year	$	100,232
Additions (Charges to Expense)		57,090
Deductions (Write-offs, net of Recoveries)		(24,197)
Allowance for credit losses, end of year	$	133,125

Discounted Cash Flows Option Disclosure Requirement

ASC 326-20-45-3 explains that if a creditor calculates the ACL based on a discounted cash flow model, it is permitted to report the entire change in the ACL as credit loss expense (or a reversal of credit loss expense).

However, a creditor may also report the change in the ACL resulting from the passage of time as interest income, but the amount recorded to interest income that represents the change in the ACL due to the passage of time must be disclosed.

Susan Colladay
Partner

Last Words about CECL

- Even if your nonprofit has never recorded an allowance for doubtful accounts before, your auditors will expect to see an allowance for credit losses recorded on January 1, 2023, and on December 31, 2023.
- To be clear … nonprofits **cannot** use the direct write off method anymore.
- Also, nonprofits will not be able to assert that all receivables are 100% collectible without significant documentation using the CECL framework to support that assertion. Even if the risk of loss is considered highly remote, nonprofits will still be required to estimate the lifetime credit losses related to the financial assets that are IN the scope of the new standard.
- Unlike the previous incurred loss model, the new expected loss model does not specify a threshold for recognizing an ACL.
- Nonprofits will need to document their ACL analysis as of January 1, 2023, using historical data, current conditions, and future conditions.
- **Share the documentation with your auditors** before your audit starts to avoid surprises or significant audit adjustments.

Crypto Assets

What we will cover today

- What are Cryptocurrencies?
- What are the specific issues that are relevant to nonprofits?
- The pros and cons.
- FASB project
- Auditing considerations.
- Key takeaways.

Polling Question #3

Has your organization received cryptocurrency yet?

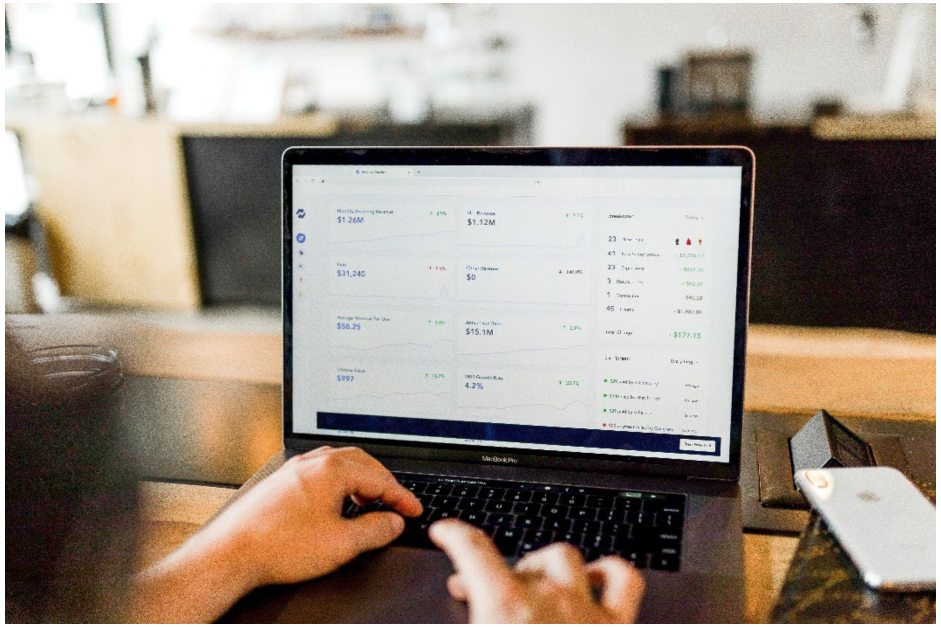
A. *Not yet*
B. *What's cryptocurrency?*
C. *Yes*
D. *We've been approached regarding receiving cryptocurrency*

What are Cryptocurrencies?

- A form of virtual digital currency that can be used to purchase goods and services.
- Currency trading on a digital marketplace.
- Secure blockchain technology that ensures the integrity of transactions and data.
- Think of blockchain as a transparent database network.
- Computers across the network track and validate the transactions.
- Decentralized – for the most part, not controlled by central governments and other regulatory bodies.
- Well-known examples include Bitcoin and Ethereum.
- New forms of cryptocurrencies are created through a digital process called ‘mining’.

Nonprofits and Cryptocurrencies

- Donor grants and contributions.
- No longer just a 'flash in the pan'.
- Larger organizations are increasingly making cryptocurrency grants.
- Nonprofits need to be aware of the accounting, auditing and tax implications.
- Management and auditor required skillsets.
- Implications for overall business strategy.

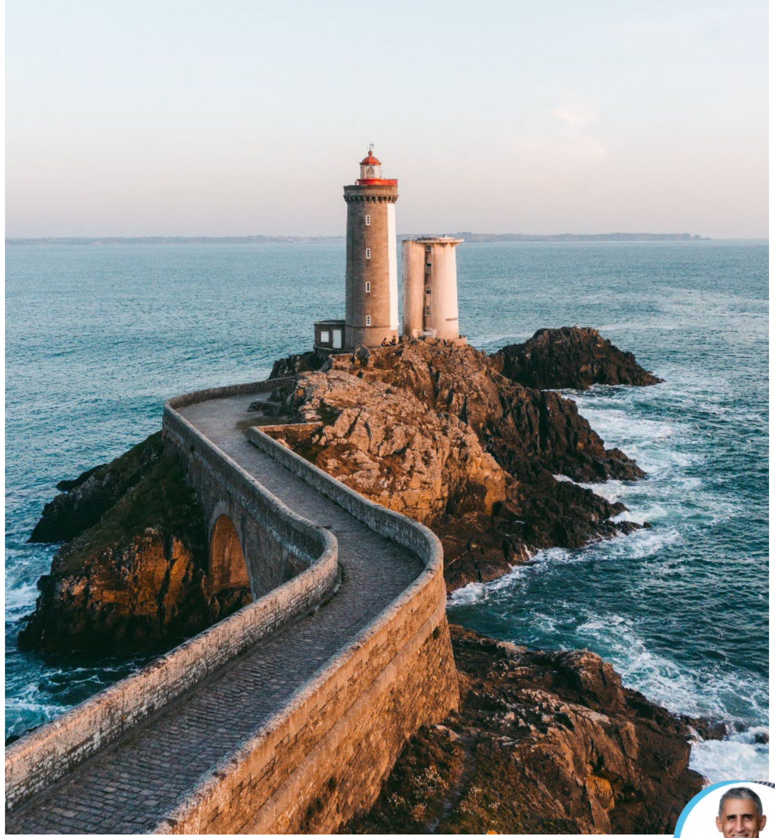


Pros and Cons

- Pros:
    - Substantial and increasing source of funds for nonprofits
    - Easy for both large and small donors to make donations, if the nonprofit has the right set-up.
    - International reach for donations
- Cons:
    - Environmental concerns, including the significant energy needed for digital 'mining' and transaction processing.
    - Market volatility
    - Challenges with technology and virtual unregulated nature of currency

Gift Acceptance and Fundraising Strategy

- Formal written policy to accept cryptocurrencies, similar to a donated stock policy.
- Policy should address:
  - Circumstances under which crypto donations will be accepted
  - Amounts and types
  - Maintain as cryptocurrencies or convert to cash at the time of donation
  - Use of third-party processors, exchanges and donor-advised funds
  - Procedures for review and approval of donations
- Include cryptocurrency logo on your website
- Update all existing donors about cryptocurrency acceptance.



Options to Liquidate and Receive Cash

- Three main options and each is more appropriate for particular nonprofits.
- **Option 1** – Use of an outsourced third-party payment processor.
  - Best option for smaller nonprofits with limited staff, and those who expect to receive contributions of lower value.
  - Nonprofits receive contributions on their website, third-party payment processor liquidates crypto receipts to USD, and transfers the proceeds of liquidation to the nonprofit's bank account.
  - Third-party payment processor sends a contribution receipt to the donor.
  - % fees to pay, depending on the size of contributions and the nonprofit.
  - Very simple solution for smaller nonprofits.

Options to Liquidate and Receive Cash (continued)

- **Option 2** – Manage everything in-house and use a crypto-exchange service.
    - More suitable for larger nonprofits who expect to receive much larger donations.
    - Need larger internal staffing capacity.
    - Nonprofit opens an account with a crypto exchange.
    - Crypto exchanges operate in a very similar way to stockbrokers.
    - Fees to pay depending on the size and frequency of donations.
    - Advantages are lower trading costs due to managing internally.
    - Disadvantages - internal staff have to be fully trained about the technical side of trading and using the crypto exchange.

Options to Liquidate and Receive Cash (continued)

- **Option 3** – Donor-advised funds (DAFs)
  - The DAF accepts the crypto contributions on the nonprofit's behalf and liquidates to USD.
  - Provides the proceeds to the nonprofit as a 'grant' based on donor's preferences.
  - Fees usually much higher.
- Best option depends on the size and staffing of the nonprofit, and the expected frequency and size of contributions.

Environmental Concerns

- Digital mining and associated energy consumption.
- Greenhouse gases and carbon footprint.
- Water consumption of power plants.
- Electronic waste – disposing of computers.
- Bitcoin Mining Council to promote energy transparency.
- The Crypto Climate Accord – more than 250 companies made a commitment to achieve net-zero emissions from electricity consumption associated with their respective crypto-related operations by 2030

Polling Question #4

What are your organization's main concerns regarding the receipt of cryptocurrency as a donation?

A. *Digital waste*

B. *Volatility of cryptocurrency*

C. *Tax and accounting treatment of the donation*

D. *All of the above*

Accounting and Auditing

FASB Project- Accounting for and Disclosure of Crypto Assets

- Added to technical agenda - May 2022
- Exposure draft - March 23, 2023 - issued Proposed Accounting Standards Update, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets.
- Exposure draft comment period and board deliberations
- Final ASU - Expected Q4 2023

FASB Project - Objectives

- Improve the accounting for and disclosure of certain crypto assets.
- Greater transparency into the fair value of crypto assets held
- Additional disclosures on types of crypto assets held and changes in holdings

FASB Project - Scope

- Applies to holdings of crypto assets that meet all of the following criteria:
  - Meet the definition of intangible assets
  - Do not provide the asset holder with enforceable rights to, or claims on, underlying goods, services, or other assets
  - Are created or reside on a distributed ledger based on blockchain technology
  - Are secured through cryptography
  - Are fungible
  - Are not created or issued by the reporting entity or its related parties.
- Non-fungible tokens (NFTs) do not meet criteria
- Applies to public, private and nonprofits

FASB Project - Measurement

Current treatment

- Treated as indefinite-lived intangible assets
- Tested for impairment
- Written down if fair value is below carrying value
- Impairment cannot be reversed if fair value rises

Proposed treatment

- Measure crypto assets in accordance with Topic 820, Fair Value Measurement.
- Expense any commissions and fees

FASB Project - Measurement

Initial measurement remains the same, including guidance in:

- Subtopic 350-30 for purchased crypto assets
- Topic 606 - crypto assets received in exchange for goods or services

Issues to consider:

- Valuation at fair value is difficult, given continuous nature of crypto markets
- Fluctuations in value

Presentation Implications for Nonprofits

Statement of Financial Position

- Present the aggregate amount of crypto assets separately from other intangible assets that are measured using other measurement bases

Statement of Activities

- Present gains and losses (changes in fair value) on crypto assets in change in net assets
- Present gains and losses separately from the Statement of Activities effects of other intangible assets, such as amortization or impairments

Presentation Implications for Nonprofits

Statement of cashflows

- Classify crypto assets received as noncash consideration during the ordinary course of business that are converted nearly immediately into cash as operating cash flows.
- A nonprofit organization that nearly immediately liquidates crypto assets received with donor-imposed restrictions for long-term or capital use would be required to classify that activity as cash flows from financing activities.
- No incremental guidance on whether to classify crypto assets as current or noncurrent assets in a classified balance sheet.
- No additional guidance on the presentation of gains and losses from crypto assets in the income statement.

Disclosure Implications for Nonprofits

- The following information about each significant crypto asset holding (as determined by the fair value of that holding) at both interim and annual periods:
  - name of the crypto asset, fair value, units held, and cost basis.
  - fair value of the crypto assets that are restricted from sale
  - nature and remaining duration of the restriction, and circumstances that could cause a lapse in the restriction
- Annual reconciliation showing:
  - additions
  - disposals
  - gains and losses

Transition and Effective Date

- Cumulative-effect adjustment to the opening balance of retained earnings at beginning of the annual period in which the guidance is adopted.
- Effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years, for all entities.
- Early adoption permitted.

AICPA and CIMA

- AICPA and CIMA set up joint working group on the Accounting and Auditing of Digital Assets.
- Guidance first issued in 2020 and continuously updated since.
- Nonauthoritative guidance for nongovernmental entities on how to account for under U.S. GAAP and audit under GAAS.
- Fast-evolving area, therefore the associated guidance will change over time.

Auditing Implications

- Client acceptance and continuance – new requirements and challenges for clients that accept crypto donations.
- New compliance and independence risks – audit team members holding same crypto assets or similar assets to those being audited.
- Competence and resources of audit firm to undertake a new engagement involving auditing cryptocurrency holdings

Auditing Implications

- Adhering to the applicable professional standards.
- Auditor skills to gain a sufficient understanding of the entity and its environment, and perform an appropriate risk assessment as the basis for the audit.
- Evolving guidance and implications for auditors.

Management and Governance

- Management needs to be aware of its responsibilities for internal controls surrounding the acceptance of cryptocurrencies, whether as investments or liquidated immediately to cash.
- Need to formally update financial and accounting policies accordingly.
- Conduct appropriate internal training for finance and accounting team.
- Enhanced evaluation of third-party service providers and their internal controls.
- Obtaining and reviewing SOC reports of third-party service providers.
- Appropriate oversight by governance.

Key Takeaways

- Pros and cons of accepting cryptocurrencies, whether or not liquidated to cash.
- Donors motivated by desire to do good in addition to tax benefits to the donor.
- Fast-evolving area.
- Be prepared - don’t wait until you are approached by a donor who wants to make a significant crypto donation and lose out because you are not ready!
- Review applicable accounting guidance.
- Review and update your gift acceptance policies.

Questions?

Contact Us

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