

Navigating Financial Challenges: Federal Funding and Financial Reporting

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With You Today



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Agenda



Understand Federal Funding Dynamics and the Financial Reporting Implications:



Revenue Recognition and Collectability and Endowment Volatility



Subsequent Events and Going Concern Considerations

Learning Objectives



Understand Federal Funding Dynamics and the Financial Reporting Implications

- Identify and analyze the financial implications of funding cliffs due to federal funding expirations, reductions, terminations, and stop work orders.
- Evaluate strategies to mitigate financial stress caused by changes in federal funding.
- Identify and evaluate the impact of risks and uncertainties on financial reporting.
- Understand the requirements for reporting subsequent events and going concern assessments



Revenue Recognition and Collectability and Endowment Volatility:

- Apply revenue recognition principles to federal and grant funding scenarios.
- Assess the collectability of receivables related to federal funding and other grants
- Analyze the impact of endowment volatility on financial stability and reporting.
- Formulate approaches to manage and report endowment-related risks.

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Subsequent Events and Going Concern Considerations:

- Recognize the indicators that necessitate for subsequent event and going concern considerations.
- Develop strategies to address and report on going concern uncertainties.



Financial Reporting Considerations in the Current Environment

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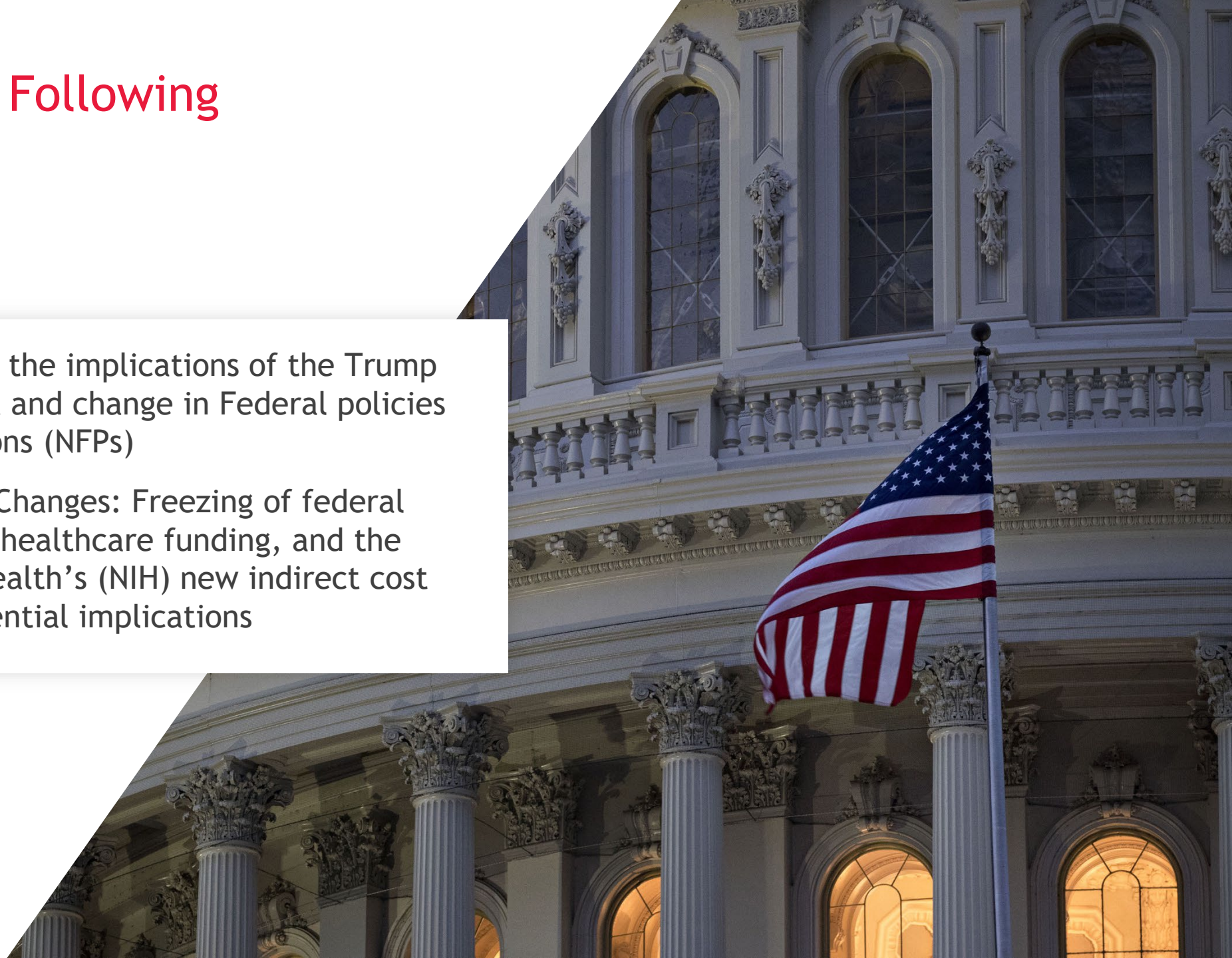
Current Events Affecting the Nonprofit Audit Environment

- ▶ Funding cliffs due to federal funding expirations, funding reductions, terminations/recissions, and stop work orders may cause financial stress
- ▶ Revenue recognition and the consideration of collectability of receivable(s) related to federal funding and other grant funds
- ▶ Increase in the need for going concern considerations
- ▶ Endowment volatility



We Will Cover the Following in This Section:

- ▶ Analyze and understand the implications of the Trump administration's agenda and change in Federal policies on nonprofit organizations (NFPs)
- ▶ Overview of Key Policy Changes: Freezing of federal grants, restructuring of healthcare funding, and the National Institutes of Health's (NIH) new indirect cost rate policy and the potential implications



Federal Funding Freeze and Spending Cuts

FEDERAL FUNDING FREEZE AND SPENDING CUTS

Policy Overview

- ▶ President Trump's directive to freeze all federal grants, loans, and financial assistance programs to conduct a comprehensive spending review.



Implementation Details

- ▶ On January 27, 2025, the Office of Management and Budget (OMB) issued Memorandum M-25-13, instructing federal agencies to pause disbursement of funds under existing grants and assistance programs
- ▶ A federal judge issued an administrative stay temporarily blocking the OMB's directive, citing lack of congressional approval and potential disruption of essential services
- ▶ Despite the court ruling, some federal agencies continued to withhold funds, leading to further legal challenges



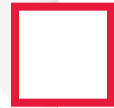
Implications for Nonprofits

- ▶ Potential cash flow disruptions due to delayed reimbursements or suspended payments
- ▶ Need to seek alternative funding sources such as private donors, corporate sponsorships, or state and local funding
- ▶ Risk of program cutbacks, staff layoffs, and service reductions if funding disruptions persist

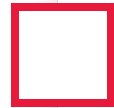


FEDERAL FUNDING FREEZE AND SPENDING CUTS

Recommended Actions for Nonprofit CFOs



Assess reliance on federal funding and explore alternative revenue strategies



Monitor cash flow and ensure liquidity reserves can withstand delays in federal disbursements



Consider cost-cutting measures, including program adjustments and staffing changes, to sustain operations



Healthcare Policy Revisions and ACA Rollbacks



Policy Overview

- ▶ Reversal of key Affordable Care Act (ACA) policies, including elimination of Medicaid expansion incentives, reversal of federal drug pricing controls on Medicare and Medicaid, and reduction of federal support for ACA enrollment programs



Implementation Details

- ▶ President Trump signed multiple executive orders aimed at rolling back ACA policies
- ▶ One executive order blocked federal funding for providers of gender-affirming healthcare for transgender youth under 19
- ▶ A federal judge in Baltimore issued a nationwide injunction preventing enforcement of the order restricting federal funding for gender-affirming care
- ▶ Several states filed lawsuits arguing that Medicaid funding restrictions violate federal healthcare laws



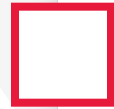
Implications for Nonprofits

- ▶ Healthcare-focused nonprofits may experience funding reductions and increased regulatory scrutiny
- ▶ Organizations providing services affected by ACA rollbacks may need to adjust program offerings and seek alternative funding sources

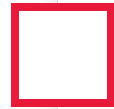


HEALTHCARE POLICY REVISIONS AND ACA ROLLBACKS

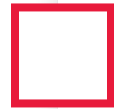
Recommended Actions for Nonprofit CFOs



Stay informed about legal developments and potential policy changes affecting healthcare funding



Evaluate the financial impact of policy changes on healthcare-related programs and services



Engage in advocacy efforts to support policies favorable to nonprofit healthcare providers



NIH's New Indirect Cost Rate Policy

NIH'S NEW INDIRECT COST RATE POLICY

Policy Overview

- ▶ On February 7, 2025, the NIH announced a policy imposing a 15% cap on indirect cost (IDC) recovery for all new and existing NIH grants awarded to institutions of higher education (IHEs)



Implementation Details

- ▶ The new policy represents a significant reduction from previously negotiated IDC rates, which often ranged from 50% to 60% of direct research costs
- ▶ On February 10, 2025, a federal judge in Boston issued a temporary restraining order preventing implementation of the policy
- ▶ A hearing was scheduled for February 21, 2025, to determine whether the order would be extended



NIH'S NEW INDIRECT COST RATE POLICY

Implications for Nonprofits

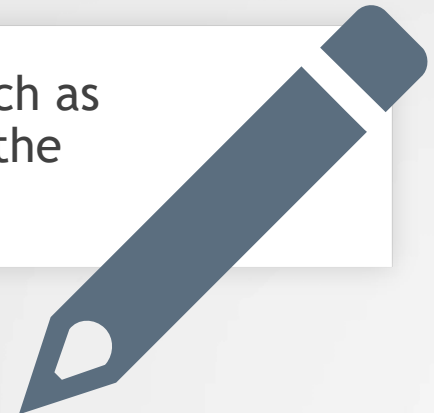
- ▶ Research institutions and universities may face substantial funding gaps due to reduced IDC recovery
- ▶ Potential need to reallocate funds or reduce research activities to accommodate funding shortfalls



NIH'S NEW INDIRECT COST RATE POLICY

Recommended Actions for Nonprofit CFOs

- ☐ Conduct financial modeling to quantify expected losses in indirect cost recovery
- ☐ Identify high-risk programs that rely heavily on NIH funding
- ☐ Develop cost absorption strategies to offset lost overhead recovery
- ☐ Engage in advocacy efforts through organizations such as the Council on Governmental Relations (COGR) and the Association of American Medical Colleges (AAMC)



Overall Strategic Recommendations



Diversify funding sources to
reduce dependence on
federal grants



Enhance **financial planning**
and **risk management**
practices



Stay informed and actively
participate in advocacy
efforts to influence policy
decisions affecting the
nonprofit sector

Impact on Collectability of Government Receivables

Due to the impact of the federal funding pause and other events that could affect government and pass-through receivables, organizations must assess the collectability of related receivables owed by the federal government to the entity either directly or from federal funding received from pass-through entities. Adjustments to the financial statements may be necessary to reflect potential changes in the collectability of these receivables due to facts that were known or knowable as of the balance sheet date.

Impact on Collectability of Government Receivables

Key considerations include:

- ▶ **Risk Assessment:** Identify risks related to grant revenue collectability
- ▶ **Assessment of Receivables:** Conduct an aging analysis and review historical collection patterns and current events and projections of cash flows to assess collectability
- ▶ **Evaluation of Grant Agreements:** Examine terms, conditions, and any amendments that may affect revenue recognition
- ▶ **Impact of Federal Funding Pause or Other Disruptions:** Assess communication with grantors and document all correspondence regarding the funding pause or other funding delays/issues and the impact on current outstanding receivables as well as future funding
- ▶ **Financial Statement Adjustments:** Evaluate the need to adjust the allowance for doubtful accounts and review revenue recognition criteria



Impact on Uncertainty in Future Federal Funding

The uncertainty surrounding federal grants can significantly impact an organization's cash flows and financial stability:

- ▶ **Revenue Dependency:** Assess concentration risk and diversification efforts
- ▶ **Cash Flow and Liquidity:** Review cash flow projections and contingency plans
- ▶ **Budgeting and Financial Planning:** Encourage scenario analysis and budget adjustments



Impact on Financial Statements



Potential Effect/Disclosures

- ▶ Impact on Operations
 - If an executive order directly affects the organization's ability to operate (e.g., rescinding of significant funding, changes in specific laws, or environmental regulations), the financial statements should disclose the nature and extent of the impact. Liquidity and available disclosures may need to be adjusted
- ▶ Compliance Costs
 - Organizations may need to disclose significant costs incurred to comply with new regulations introduced by an executive order, such as changes to reporting systems or operational adjustments
- ▶ Risk Factors/Going Concern
 - If an executive order introduces uncertainties or risks (e.g., potential penalties for noncompliance or going concern issues), disclosures might be warranted

Potential Effect/Disclosures

▶ Subsequent Events

- If an executive order is issued after the financial statement reporting period but before the financial statements are issued, that impacts an organization it may need to be disclosed as a subsequent event, especially if there is a material impact

▶ Government Assistance or Restrictions

- Disclosures may also need to include details about government assistance received due to an executive order (e.g., grants or subsidies) or restrictions imposed (e.g., limitations on funding use)

Subsequent Events

When assessing subsequent events, organizations must determine whether these events should be reflected in the financial statements. This assessment involves distinguishing between the two types of subsequent events outlined in ASC 855:

- ▶ **Recognized Subsequent Events (Type 1):** These events provide additional evidence about conditions that existed at the balance sheet date and require adjustments to the financial statements
- ▶ **Non-recognized Subsequent Events (Type 2):** These events indicate conditions that arose after the balance sheet date. While they do not require adjustments to the financial statements, they should be disclosed if they provide important information to users of the financial statements

Subsequent Event Disclosures

When considered appropriate, subsequent event disclosures should include:

- ▶ Description and nature of the event
 - Clearly outline the event and its relation to the organization's operations or financial position
- ▶ Estimate of the financial effect
 - Provide an estimate of the financial impact. If it is not practical to make an estimate, a statement to that effect should be included

Illustrative Subsequent Event Disclosure

On January 27, 2025, President Donald J. Trump issued executive orders to temporarily suspend federal financial assistance obligations and disbursements. This action aligns with the administration's priorities to realign federal spending. Several of the Organization's programs rely on federal funding, and this temporary pause poses significant challenges and uncertainties. The Organization is actively engaging in strategic planning to navigate this period of fiscal uncertainty. Given the changing landscape related to federal funding, the Organization is not able to estimate the effects on its changes in net assets, financial condition, or liquidity for the fiscal year 20XX, [though extended delays or reductions in planned funding (*address specific facts and circumstances*)].

Illustrative Subsequent Event Disclosure

If the engagement team believes there could be a material adverse effect on the Organization add the following to the illustrative example on the prior slide:

[Due to [discuss specific facts and circumstances], this will likely have a material adverse effect on the Organization, including impairments to [long-lived assets acquired with federal funding or used for federal programs], [right of use assets acquired with federal funding or used for federal programs], [and other assets or liabilities that are in risk of default].

Going Concern Issues

- ▶ In extreme cases, the effect of a subsequent event may be so pervasive that it raises questions about the organization's viability as a going concern. In such cases, thorough disclosure is crucial and may require a going concern modification to the audit report
- ▶ A thorough review of the management's going concern evaluation is crucial in these cases
- ▶ Management should consider (under ASC 205-40) and auditors (under AU-C 560), should consider the impact of the federal funding pause, and changes to federal funding should be included in the analysis of the key going concern assessment factors.
- ▶ Once the going concern analysis is complete, management and engagement teams need to form a conclusion on whether there is substantial doubt about the organization's ability to continue as a going concern and ensure that any necessary disclosures are made in the financial statements

Current Endowment Issues

- ▶ Increased borrowing from endowment funds
 - This can provide critical liquidity during financial distress; however, this must be carefully managed to avoid violating donor restrictions and legal requirements
 - Auditors need to make sure the client addressed all the requirements and ensure proper disclosures of this scenario are made in the notes
- ▶ Policy for spending on underwater endowments
 - Entities may suspend distributions to allow the fund to recover, but must be careful to ensure compliance with donor intent and relevant laws
 - Auditors need to consider the market volatility, legislative changes affecting investment strategies and the pressure on the entity to maintain program funding despite reduced endowment values

Summary of Impacts

The Trump administration's 2025 policy changes present significant financial and operational challenges for nonprofits, particularly those reliant on federal funding and involved in healthcare and research.



Questions?





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