FASB Issues New Standard for Financial Statement Presentation by NFPs

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On Aug. 18, 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-14 (ASC Topic 958), which has the stated objective of improving existing standards for financial statement presentation by not-for-profit entities (NFPs). Specifically targeted for improvement are the following areas:

- Net asset classification
- Liquidity and availability of resources
- Expenses and investment returns
- Operating cash flows

Why the Changes?

ASU 2016-14 represents the first major set of changes to NFP financial statement presentation standards since the issuance of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, in 1993. FASB originally initiated the project based on recommendations of its NFP Advisory Committee (NAC) in 2011.

The project is part of FASB's ongoing review of Generally Accepted Accounting Principles (GAAP) to ensure that they continue to meet the evolving needs of a dynamic financial reporting environment. In issuing the standard, NAC stated its belief that although existing financial reporting standards for NFPs are sound, they could be updated and improved to better enable NFPs to "tell their financial story" to constituent groups, such as donors, grantors and creditors.

Which Entitles are Affected?

ASU 2016-14 affects substantially all NFPs, including charities, foundations, private colleges and universities, nongovernmental health care providers, cultural institutions, religious organizations and trade associations, among others.

Following is a brief overview of the targeted financial statement presentation areas and changes.

Net Asset Classification

The current model contains three classifications for net assets of the NFP: (1) unrestricted, (2) temporarily restricted and (3) permanently restricted. FASB research revealed that users felt that these classifications were often overly complex and broadly misunderstood.

The new financial presentation model replaces these three classes with two new classes: (1) *without donor* restrictions; and (2) *with donor* restrictions. In addition, the new standard adds a further disclosure requirement that net assets *without* donor restrictions also disclose the amount, purpose and type of *board designations* within this category.

"Underwater endowments" (those in which the original endowment amount exceeds the current fair value of net assets in the fund) are required to be reflected in net assets *with donor restrictions*, rather than without such restrictions (as required in the current standard). In addition to the current requirement to disclose aggregate amounts by which funds are underwater, the new standard requires disclosure of the aggregate original gift amounts for such funds, fair value and any governing board policy or actions being taken that concern future appropriations from such funds. (In other words, what the board is doing about the underwater condition.)

The new standard also requires that for gifts of cash restricted for acquisition and construction of property and equipment (in the absence of explicit donor restrictions), all NFPs would be required to use the "placed in service" date as the date of releasing these assets from restriction. Thus, the previous "over time" approach for the expiration of restriction on capital gifts is eliminated.

Liquidity and Availability of Resources

ASU 2016-14 includes specific requirements directed at improving a user's ability to assess the NFP's available financial resources and management of its liquidity and risk. Specifically, all NFPs are required to provide:

- Qualitative information (generally footnote) on how liquid available resources and liquidity risk are managed; and
- Quantitative information (usually in the body of the statements) that communicates the ability of the NFP's financial assets at the balance sheet date to meet its cash needs for general expenditures within one year. In plain English, the NFP is required to describe how it is managing its funds to help ensure that it can pay its bills as they become due.

Expense Reporting and Investment Returns

The new standard requires that the NFP report expenses, either on the face of the financial statements or in the footnotes, by (1) function (i.e., HR, services, instruction, etc.); and (2) natural classification (i.e., travel, salary, benefits, etc.). The current standard requires categorization only by function. The new standard requires a separate expense analysis (probably footnote) by both function and nature. It also requires the NFP to provide qualitative disclosures about the methods it used to allocate costs among program and support functions.

NFPs are required to present investment returns on endowment funds *net of all related external and direct internal* expenses. NFPs will no longer be required to disclose the *components* of investment returns (i.e., interest, dividends, gains/losses and expenses).

Operating Cash Flows

ASU 2016-14 permits NFPs to continue to choose either the direct or indirect method of computation of operating cash flows. Unlike the current standard, however, the new standard eliminates the requirement for a reconciliation to the indirect method for those NFPs that choose the direct method.

Effective Date

These sweeping changes are scheduled to take effect for annual financial statements issued for fiscal years beginning after Dec. 15, 2017, and for interim periods within fiscal years beginning after Dec. 15, 2018. NFPs are encouraged to get started early with a program of informing board members and staff. For a detailed copy of the new standard, see www.fasb.org. ■

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