FASB's New Standard Aims to Improve Not-for-Profit Financial Reporting

ASU 2016-14 Replaces the Reporting Model That Has Existed for 20 Years

by AICPA Not-for-Profit Section
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After more than three years of debate, comment, and revision, the Financial Accounting Standards Board's (FASB) much-anticipated Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, was released on August 18, 2016. The ASU will change the way all not-for-profits (NFPs) classify net assets and prepare financial statements. To view the standard in its entirety, visit the FASB's website here.

Adoption of FASB ASU 2016-14 will result in significant changes to financial reporting and disclosures for NFPs. FASB believes the update will improve NFP financial statements and provide more useful information to donors, grantors, creditors, and other financial statement users. The standard is effective for annual financial statements issued for fiscal years beginning after December 15, 2017 and for interim periods within fiscal years beginning after December 15, 2018.

Improvements to NFP Financial Reporting

The first of a two-phase project, the amendments in FASB ASU 2016-14 are intended to make immediate improvements that address:

- Complexity in net asset classification
- Clarity of information regarding liquidity and availability of cash
- Transparency in reporting of financial performance measures
- Consistency in reporting expenses by function and nature
- Utility of the statement of cash flows

Net Asset Classifications

As a result of the new standard, the three existing classes of net assets (unrestricted, temporarily restricted, and permanently restricted) will now become two:

- Net assets without donor restrictions
- Net assets with donor restrictions

To enhance readers' understanding of the donor restrictions, footnote disclosures will be required to include the timing and nature of the restrictions, as well as the composition of net assets with donor restrictions at the end of the period. The disclosures will continue to show an analysis by time, purpose and perpetual restrictions.

Underwater Endowments

As part of the change to classification of net assets, endowments that have a current fair value that is less than the original gift amount (or amount required to be retained by donor or by law), known as "underwater" endowments, will now be classified in net assets with donor restrictions, instead of the current classification in unrestricted net assets. Expanded disclosures will be required to include the following information:

- The original amount of the endowment
- The NFP's policy relating to spending from these funds
- Whether that policy was followed

Board-designated Net Assets

At times, an NFP's governing board may make designations or appropriations that result in self-imposed limits on the use of resources without donor restrictions, known as board-designated net assets; enhanced disclosure information will be required on the amounts and purposes of these designations. In addition, the placed-in-service approach will be required when releasing restrictions related to long-lived assets. The option to imply a time restriction and release the restriction over an asset's useful life will no longer be permitted.

Transparency and Utility of Liquidity Information

Quantitative and qualitative information about liquidity will be required for the purpose of providing financial statement users with an understanding of an entity's exposure to risks, as well as how an entity manages its liquidity risk, and information about the availability of assets to meet cash needs for general expenditures within one year of the balance sheet (statement of financial position) date. Presenting a classified balance sheet may an effective way for organizations to comply with many of the new disclosure requirements.

Reporting Financial Performance Measures

Reporting the change in total net assets for the period continues to be a requirement. In addition, NFPs will also report the amount of change in each of the two classes of net assets in the statement of activities. Presenting an intermediate measure of operations is still allowable; however, disclosures will be enhanced to provide additional information about the items included or excluded from the operating measure.

Presentation of Investment Expenses

A net presentation of investment expenses against investment return will be required on the face of the statement of activities. External and direct internal investment expenses will be netted against the investment return. A disclosure of the components of investment expense will no longer be required.

Expenses Classified by Function and Nature

An analysis of expenses by both function and natural classification will be required for all NFPs on a separate statement, on the face of the statement of activities, or in the footnotes. While a separate statement of functional expenses is not required, it may be the most effective presentation option for NFPs with more than one program. Investment expenses that have been netted against investment return are not permitted to be included in that analysis. Additional disclosures will also be required regarding specific methodologies used to allocate costs among program and support functions.

Presentation of Cash Flow Information

Under the new standard, NFPs may continue to present cash flows from operations using either the direct or indirect method. However, NFPs will no longer be required to present the indirect method reconciliation if the direct method is used. The intent of this change is to allow an organization to select the presentation method that best serves the needs of the entity, providing greater flexibility in financial reporting.

Implementation of the New Standard

While the changes seem numerous, implementing the majority of them should not be onerous. FASB staff is encouraging early adoption of the standard. They point out that most of the new requirements are currently available as options within GAAP and can be used without formally adopting ASU 2016-14 early, except for the following items:

- Combining the temporarily restricted and permanently restricted net asset classes into one net asset class
- Presenting a deficit situation in endowments in a restricted net asset class rather than in unrestricted net assets
- Eliminating the disclosure of investment expenses that are netted against investment returns
- Eliminating the indirect method reconciliation when using the direct method on the

statement of cash flows

Next Steps

There is no doubt that the new standard will impact all NFPs issuing GAAP-basis financial reports. However, the effects on various stakeholder groups within the nonprofit sector will vary. A future Phase 2 of FASB's project is slated to address additional issues, including:

- Operating measure: All other elements of the proposal not addressed in Phase 1, including:
  - Whether to require intermediate measure(s)
  - Whether and how to define such measure(s) and what items should be included
- Alignment of measures of operations in the statement of activities with measures of operations in the statement of cash flows.

There is currently no expected timeframe for the completion of the second phase. For background information on the original proposal and to learn about planned activities of the FASB's not-for-profit entity team, go here.

Additional Resources

With early adoption permitted and encouraged for future year-ends, many organizations are preparing now for this transition. The AICPA Not-for-Profit Section will continue to provide news updates and implementation resources as they become available.

Applying FASB's New Financial Statement Standard (PDF)
Download the presentation materials from AICPA's recent webcast on this topic.

Illustrative Financial Statements (PDF)
View a non-authoritative example of a possible presentation of a complete set of financial statements under the new reporting model.

This symbol identifies tools and resources available exclusively for Not-for-Profit Section members. When accessing premium content, you will be prompted to enter your user ID and password to validate your membership.

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