

# FASB's Not-for-Profit Financial Statements Project

**CLA National Association Executives Conference  
September 17, 2015**

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*The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.*



# Agenda

- Why are we doing the project?
- What changes did we propose?
- What are we hearing in response?
- What happens from here?
- Q&A

# Why Are We Doing the Project?

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# NFP Financial Statement Model

- Last overhauled approximately 20 years ago
  - FAS 117 (now codified in Topic 958 of the ASC)
- Represented significant change from previous guidance
  - Significant differences across the sector
  - Significant differences from business entities
- Standards kept at a somewhat high level, with expectation that guidance would evolve in certain areas (e.g., operating measure)
  - Has happened, but to a limited degree

# NFP Financial Statements Project—Key Objectives

(recommended by FASB’s NFP Advisory Committee (NAC))

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
  - Financial performance
  - Cash flows
  - Liquidity
- Better enable NFPs to “tell their financial story”

# Scope and Types of NFPs

Charitable/Public Support	Hybrids	Businesslike
Voluntary Health & Welfare	Performing Arts	<b>Trade &amp; Professional Associations</b>
<ul style="list-style-type: none"> <li>• Social Service</li> <li>• United Ways</li> </ul>	<ul style="list-style-type: none"> <li>• Operas</li> <li>• Symphonies</li> </ul>	Social and Country Clubs
Religious Organizations	Museums and Zoos	Cemetery Organizations
Community Foundations	Colleges & Universities	
Public Broadcasting	Fundraising and Supporting Organizations	
Environmental Protection		
Some Children's Hospitals	Research/Educational Hospitals	Health Care Systems
<ul style="list-style-type: none"> <li>• Shriner's Hospitals</li> <li>• St. Jude's</li> </ul>		<ul style="list-style-type: none"> <li>• Hospitals</li> <li>• Nursing Homes, CCRCs</li> <li>• Physician Practices, HMOs</li> </ul>
<b>Outside the Scope</b>		

Investor-owned entities, employee benefit plans, and entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants. Examples include mutual insurance companies, credit unions, and farm and rural electric cooperatives.

# What Changes Did We Propose?

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# Changes in Key GAAP Metrics

Line Item	Current	Proposed
<b>Balance Sheet</b>		
Unrestricted Net Assets	✓	✓
Temporarily Restricted Net Assets	✓	✓
Permanently Restricted Net Assets	✓	✓
Totals for Assets, Liabilities, and Net Assets	✓	✓
<b>Revenue, Expenses, and Other Changes</b>		
Operating Excess/Deficit Before Transfers		✓
Operating Excess/Deficit After Transfers		✓
Investment Return, Net		✓
Health Care Performance Indicator	✓	
Change in Unrestricted Net Assets	✓	✓
Change in Temporarily Restricted Net Assets	✓	✓
Change in Permanently Restricted Net Assets	✓	✓
Total Change in Net Assets	✓	✓

# Other Significant Proposed Changes

- Direct method cash flows (indirect would be optional), with certain realignments
- Expenses: nature-by-function (choice of location), with related disclosure
- Reporting of “underwater” endowments, with enhanced disclosure
- New required disclosures:
  - Board designations
  - Information useful for assessing liquidity

# Net Assets - Issues

- URNA Misinterpretation
- TRNA “Hodgepodge”
- UPMIFA and PRNA/TRNA Distinction

# Net Assets

**Current  
GAAP**

Unrestricted

Temp.  
Restricted

Perm.  
Restricted

**Proposed  
GAAP**

Without Donor  
Restrictions

With Donor Restrictions

+

**Disclosures**

Amount, purpose,  
and type of board  
designations \*

Nature and amount  
of donor restrictions

\* New disclosure requirement

# “Underwater” Endowments

## Revised net asset classification

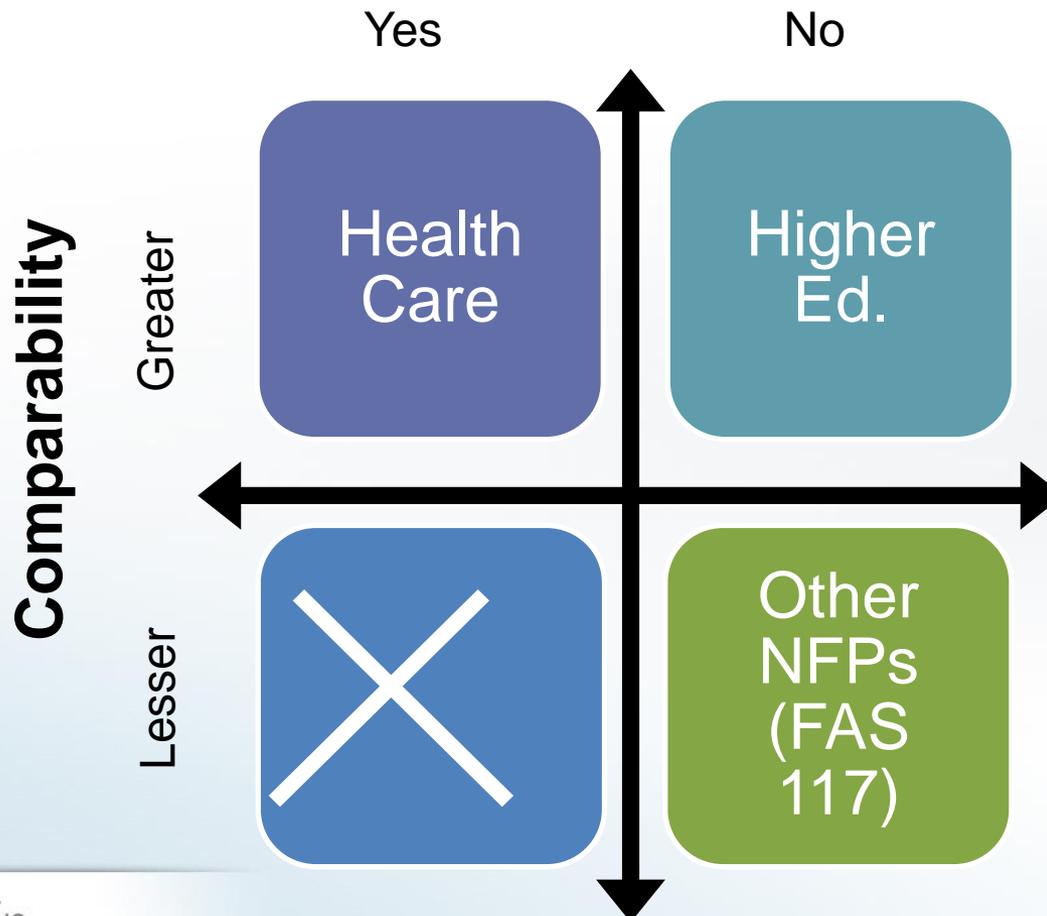
- To be reflected in net assets with donor restrictions rather than in net assets without donor restrictions

## Enhanced disclosures

- In addition to aggregate amounts by which funds are underwater (current GAAP), also disclose aggregate of original gift amounts (or level required by donor or law) for such funds, fair value, and any governing board policy or decision to reduce or not spend from such funds.

# Financial Performance: Operating Measures – Current Landscape

Required *operating* measure?



# Financial Performance: Operating Measures

Defined **required** intermediate operating measures for all NFPs—based on two dimensions:

Tension Points:

*Interest Expense*

*Internal Actions*

*Capital-like*

*Transactions*

## **Mission (Business & Charitable Activity):**

based on whether resources are from or directed at carrying out an NFP's purpose for existence (generally vs. investing and financing)

**AND**

## **Availability:**

based on whether resources are available for current period activities and reflecting limits imposed by:

-external donors

-internal actions of an NFP's governing board

# Presentation of Transfers

Balances aims of **comparability** and **flexibility**. NFP would present:

1. Operating measure before transfers (reflects all current, legally available amounts generated/used during operations)
2. All internal transfers (decisions to designate otherwise available amounts as unavailable, or vice versa) in a discrete section, but before the operating measure after transfers.
  - At a minimum, present aggregated line items of transfers from & transfers to operating activities
  - Provide details in a note if not on the face

**Operating Excess (Deficit) before Transfers**

**+Transfers to Operating Activities**

**-Transfers from Operating Activities**

**Operating Excess (Deficit) after Transfers**

# Gifts of, or for, Property, Plant & Equipment

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## Gifts of PP&E without donor restrictions

Initial period: all unrestricted gifts reported *within* operations; then entire amount transferred *out* of current operations if gifted asset is placed in service (instead of monetized)

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## Gifts of cash restricted for acquisition or construction of PP&E

Initial period: reported as revenues that increase net assets *with* donor restrictions

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Thereafter: release of donor restriction *into* operations; concurrent transfer of entire gift *out* of current operations

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NFPs would be required to use the **placed-in-service** approach (*no more implied time restrictions*)

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For practical and other reasons, **no subsequent transfers** of gift amount back into operations **to match depreciation**

# Financial Performance: Statement Approach

## 1 Statement

- Ability to present total revenue and contributions
- Effect of transfers easier to identify
- Too much information in one statement
- Labeling of totals difficult

## 2 Statement

- Greater emphasis on the operating measure
- Facilitates multi-year comparison
- Some may ignore the second statement
- Incorrectly equate the operating measure to net income

Retain  
Flexibility

# Reporting of Expenses

Analysis of operating expenses by nature **and** function → one place in the F/S (statement of activities, separate statement, or schedule in notes), with additional qualitative information about cost allocations

FUNCTION

Functionalization is optional

NATURE

	Program Activities		Supporting Activities		Total Operating Expenses	Non-Operating	Total Expenses
	Program A	Program B	M&G	Fundraising			
Salaries & Benefits							
Grants to Others							
Equipment Rental & Maintenance							
Occupancy Cost							
Depreciation							
Information Technology							
Professional Service Fees							
Supplies							
Travel							
Printing & Publication							
Interest							
Other							
<b>Total</b>							

\* Either nature or function (or both) on face of Statement of Activities

# Reporting of Investment Returns

## How to present?

- **Net presentation** of investment expenses against investment return on the face of the statement of activities
  - Netting limited to external and **direct** internal expenses

## What to disclose?

- Disclosure of investment expenses **no longer required, except for** the disclosure of the amount of internal salaries and benefits that have been netted (if any) against investment return
- No longer require disclosure of investment income **components**

# Cash Flow Statement

## Why underutilized/ unutilized?

**#1**

- The Indirect Method

**#2**

- Disconnect with Statement of Activities (and any operating measure therein)

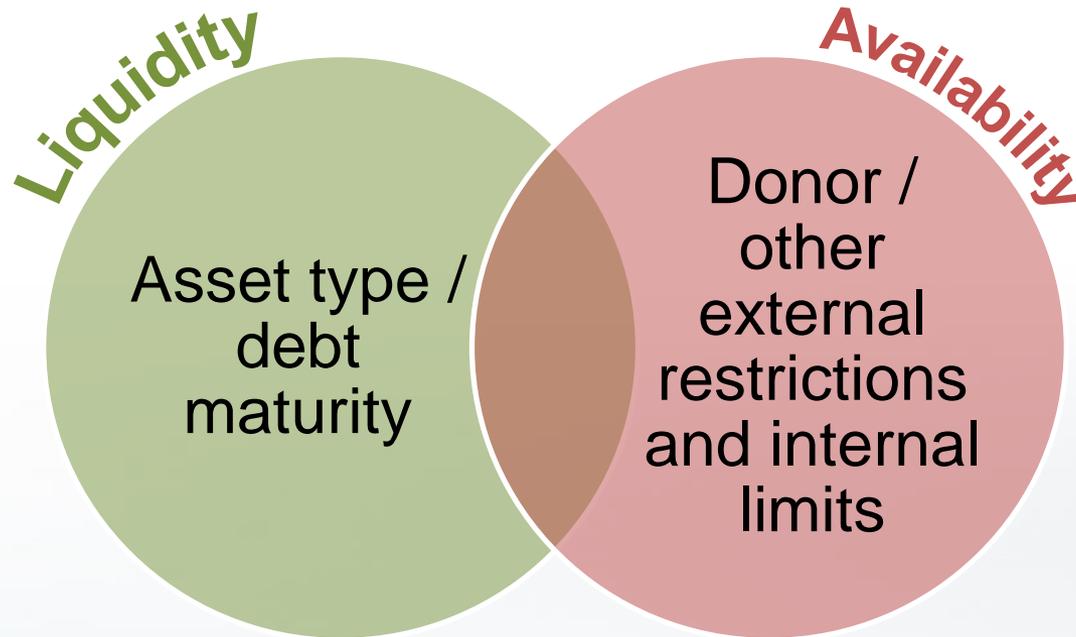
# Cash Flow Statement

- Require **Direct Method** for operating cash flows
  - No longer require, but permit, indirect method
  - *Should indirect method still be required for certain NFPs?*
- **Re-categorize** certain items to better align operating cash flows with the operating measures
  - *From Investing/Financing to Operating:*
    - Purchases of and proceeds on sale of long-lived assets (e.g., PP&E; capitalized and noncapitalized collections)
    - Cash gifts restricted for long-lived assets
  - *From Operating to Investing/Financing:*
    - Cash from interest and dividends
    - Interest paid

# Cash Flow Statement

<b>Cash Flows from Operating Activities</b>	
Cash received from service recipients	
Cash received from donors	
Cash paid to employees	
Cash paid to vendors	
Purchase of property and equipment	
Proceeds on sale of property and equipment	
Contributions restricted for property and equipment	
<b>Net cash from operating activities</b>	
<b>Cash Flows from Investing Activities</b>	
Cash received from interest and dividends	
Purchase of investment assets	
Proceeds from sale of investments	
<b>Net cash from investing activities</b>	
<b>Cash Flows from Financing Activities</b>	
Payments of principal on long-term debt	
Interest paid on long-term debt	
Contributions restricted for endowment	
<b>Net cash from financing activities</b>	
Net increase in cash	
Cash at the beginning of year	
<b>Cash at end of year</b>	

# Liquidity and Financial Availability



## FASB discussed:

- Classified balance sheet
- Separate presentation of assets whose use is limited
- Additional note disclosure

# Disclosures Useful for Assessing Liquidity

- An NFP would define the time horizon it uses to manage its liquidity (for example, 30, 60, or 90 days) and disclose the following information:
  1. **Quantitative information** about:
    - a) The total amount of financial assets
    - b) Amounts that are not available to meet cash needs within the time horizon because of (1) external limits and (2) internal actions of a governing board
    - c) The total amount of financial liabilities that are due within that time horizon.
  2. **Qualitative information** about how the entity manages its liquidity. For example, an entity might disclose:
    - a) Its strategy for addressing entity-wide risks that may affect liquidity, including its use of lines of credit
    - b) Its policy for establishing liquidity reserves
    - c) Its basis for determining the time horizon used for managing liquidity.

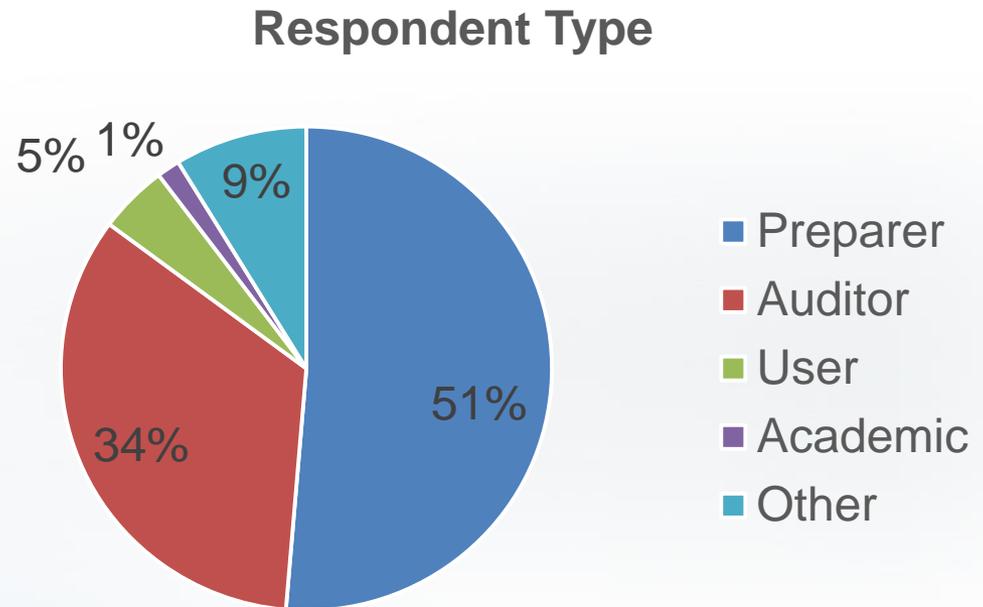
# What Are We Hearing in Response?

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# Who did We Hear From?

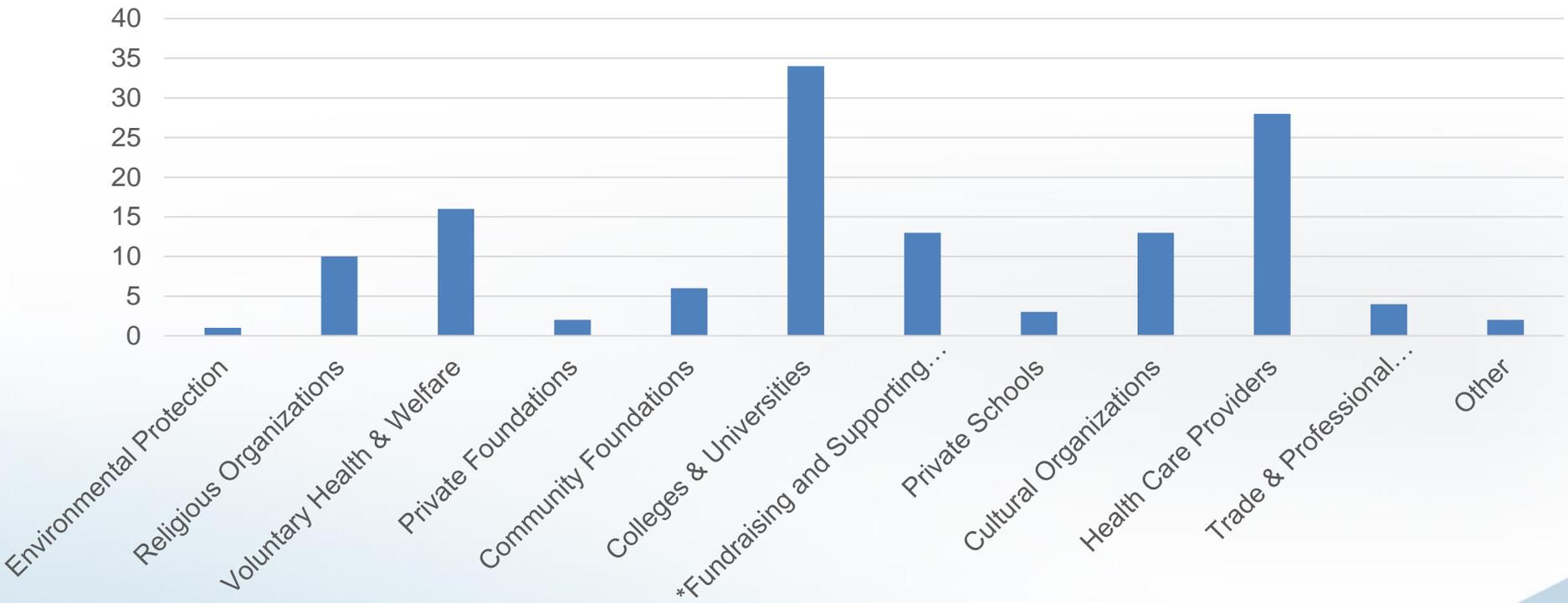
## ■ 263 Comment Letters

- 135 Preparers
- 89 Auditors
- 12 Users
- 4 Academics
- 23 Individuals and Others



# Types of Preparers We Received Comment Letters From

Preparer Industry Type

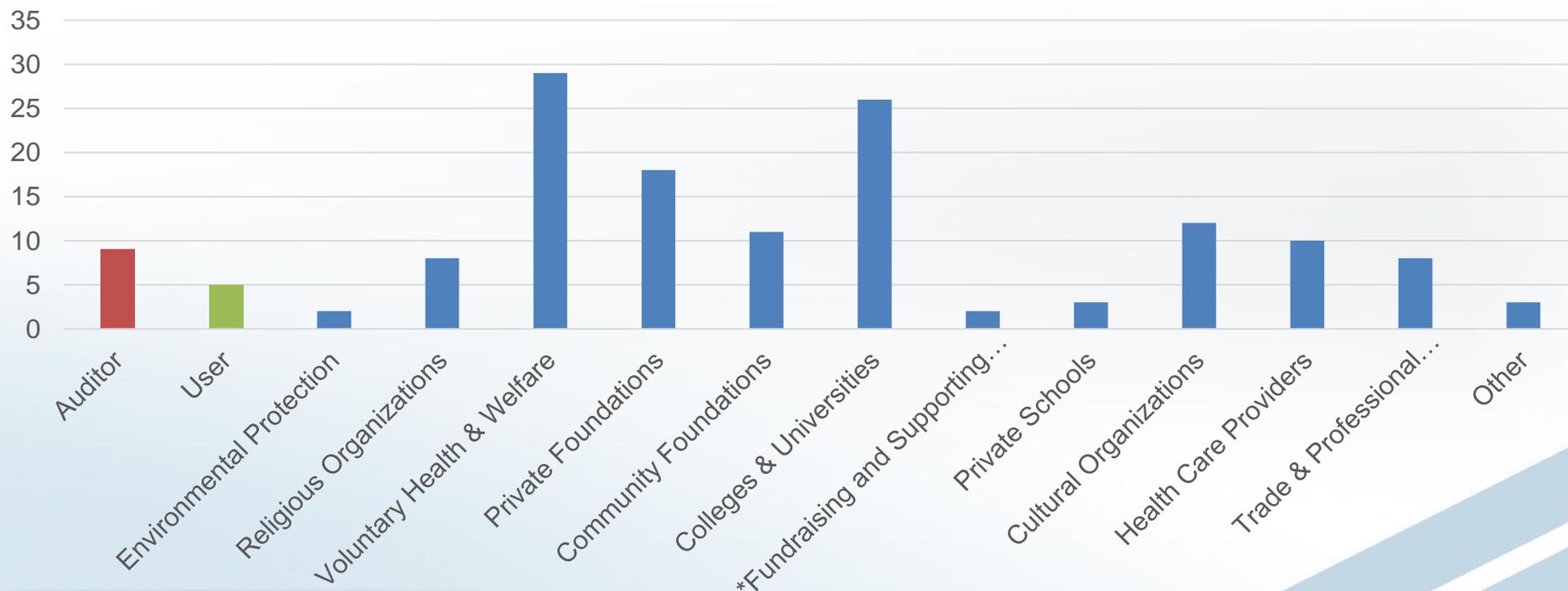


\*Including Institutionally Related Foundations

# Types of Workshop Participants

- 10 Workshops in 5 Cities (Atlanta, Charlotte, Chicago, Dallas, and Denver)
- 146 Total Participants

Respondent Type



\*Including Institutionally Related Foundations

# Overall Common Themes

- Support for Board's overall objective to update current model.
- Desire by many to maintain as much consistency as possible between NFPs and For-Profit reporting requirements.
  - Comparability within industries (NFPs and similar For-Profit entities) may be more important than comparability between dissimilar NFPs, especially for more “business-like” NFPs.
  - Most users come from For-Profit background.

# Overall Common Themes

- Desire for a proposal that allows sufficient flexibility to reflect differences among NFPs.
  - Industry differences
  - Size differences
- Concern regarding the potential cost to implement some of the proposals, especially for small NFPs.

# Combining Temporarily and Permanently Restricted Net Assets

- Overall **support** for combining two classes of net assets.
  - Suggest changes provide simplicity, may increase user understandability.
- Those who disagree:
  - Argue permanent restrictions fundamentally different from temporary restrictions, should remain on face of statement.
  - Express concern that: users may not read notes, important distinctions may become lost/blurred in notes.

# Underwater Endowments

- Overall **support** for classifying underwater endowment funds within net assets with donor restrictions rather than net assets without donor restrictions.
- Overall **support** for disclosure of NFP's policy on spending from underwater endowment funds together with aggregate gross amounts for such funds (FV versus amount required to be maintained).

# Intermediate Measures of Operations

- **Mixed** feedback for required intermediate measures of operations.
  - Many agree with requiring intermediate measures of operations, but disagree with the measures proposed. Some specifically express a desire for either:
    - Clarification of definition of “mission” and what should or should not be included in operations.
    - More flexibility for NFPs to determine their own definition for operations and what to include in operations.
    - Requiring single intermediate measure of operations instead of two measures.

# Intermediate Measures of Operations

- Many who disagree note one or more of the following:
  - Separating activity into operating and non-operating would not increase comparability because of significant differences in operating activities among different types of NFPs.
  - Management would have ability to manipulate classification of resources.
  - Two intermediate measures of operations would increase financial statement complexity.
  - NFP financial reporting should remain consistent with (flexible as) For-Profit financial reporting.
    - Some of these respondents have suggested pursuing a different type of intermediate measure, somewhat analogous to net income/ the health care performance indicator, for now.

# Interest Expense

- Overall **disagreement** that interest expense and fees and related expenses incurred are not directed at carrying out NFP's purpose and, thus, should not be classified as operating activities.
  - Auditors & academics have more mixed views, while most others disagree.
  - Many that agree suggest acquiring debt may help NFP carry out its mission, but NFP not in business of acquiring or disposing of debt. Thus, interest expense not an operating activity, but a financing activity.
  - Many that disagree:
    - Express concern that NFPs with lending/financing directly tied to mission would be precluded from classifying interest expense as operating.
    - Suggest interest expense is direct cost of doing business and belongs in operating.
    - Express concern that proposal would reduce comparability with for-profits.
    - Suggest classification should be determined by what assets are being financed by the borrowing (working capital versus "bricks and mortar").

# Transfers

- Overall **disagreement** concerning presentation of all internal transfers on the face of the Statement of Activities.
  - Some concern that:
    - It's inappropriate to include impact of internal events in operating results.
    - Management would have ability to manipulate classification of resources.
    - Transfers make Statement of Activities too complex.
  - Many suggest disclosure of transfers in notes to financial statements.
- Some Suggested Alternatives:
  - Report program service income and expenses in operating, and contributions and investing activity below operating, with roll-forward note disclosures about internal transfers.
  - Limit presentation of board decisions on face of statement to those related to designations for/ appropriations from endowment funds.

# Gifts of, or for, Property, Plant, and Equipment

- Overall **disagreement** with notion that gifts of PP&E or cash to acquire/ construct PP&E are “operating” revenues and support.
  - Many would prefer such gifts be recorded directly in non-operating:
    - Concern for added volatility to (first) intermediate measure of operations.
    - Capital-related gifts not operating activities.
    - Capital-related gifts not available for the current period, unless monetized.
  - Many disagree because they disagree with transfer model (see slide 36).

# Gifts of, or for, Property, Plant, and Equipment

- Overall **support** to require reporting of expirations of donor restrictions on gifts of cash or other assets used to acquire/construct PP&E using placed-in-service approach.
  - Most who disagree acknowledge placed-in-service approach is more widely used, but would prefer that both placed-in-service and implied time restriction approaches remain as options.

# Reporting of Operating Expenses by Function and Nature

- Overall **support** for all NFPs to report analysis of operating expenses by both function and nature in single location (generally in notes)
  - Suggest it aids in user understanding and comparability across industries.
- Some who disagree:
  - Express concern that cost of requiring such analysis for all NFPs would exceed benefits, especially for NFPs that are small or receive little in contributions/ public support.
    - Many such respondents do agree that expenses by nature should be required in addition to (or instead of) expenses by function for all NFPs, but disagree about requiring analysis for all NFPs.
  - Express concern with lack of consistency between Form 990 and proposed GAAP analysis.
  - Prefer that reporting of expenses by both function and nature remain optional.

# Reporting of Investment Returns

- Overall **support** to report investment income net of external and direct internal investment expense.
  - Some who disagree are concerned that net amount could be manipulated.
- Overall **agreement** that disclosure of all investment expenses is unnecessary but **disagreement** that disclosure of internal salaries and benefits netted against investment return should be required.
  - Some who disagree prefer all investment expenses disclosed for transparency.
  - Most, however, agree that disclosure of all investment expenses is unnecessary, **including** internal salaries and benefits.
    - Disclosing salaries and benefits could result in identification of salaries of specific employees.
    - Internal salaries likely immaterial for many NFPs.
    - Wouldn't give complete picture of salaries and benefits anyway, because of other "missing" amounts (e.g., salaries and benefits capitalized in inventory).

# Direct Method of Presenting Operating Cash Flows

- **Mixed** feedback for requiring direct method of presenting operating cash flows.
  - Most acknowledge that direct method is more understandable than indirect method.
  - Most workshop participants and several respondents that have adopted direct method support requiring it and no longer requiring indirect method.
    - They generally indicate that benefits exceed incremental implementation costs as well as ongoing costs.

However...

# Direct Method of Presenting Operating Cash Flows

- Most oppose requiring direct method at this time for differing reasons:
  - Current requirements should not be changed until requirements change for business entities.
    - For now, NFPs should have option to present either direct or indirect method.
      - » Some of these respondents may not understand that indirect method is currently required for all entities even if not presented on face of cash flow statement.
  - Concern that incremental benefits of switching to direct method would not justify costs.
  - Neither method is clearly superior to other.
  - Users will continue to underutilize statement of cash flows regardless of method presented.

# Indirect Method of Presenting Operating Cash Flows

- Overall **mixed** feedback on whether to retain indirect method.
  - Many believe no necessary information would be lost if indirect method no longer required.
    - However, many of these respondents and others prefer to retain reconciliation of operating cash flow to total change in net assets.

# Alignment of Operating Items on Statement of Cash Flows and Statement of Activities

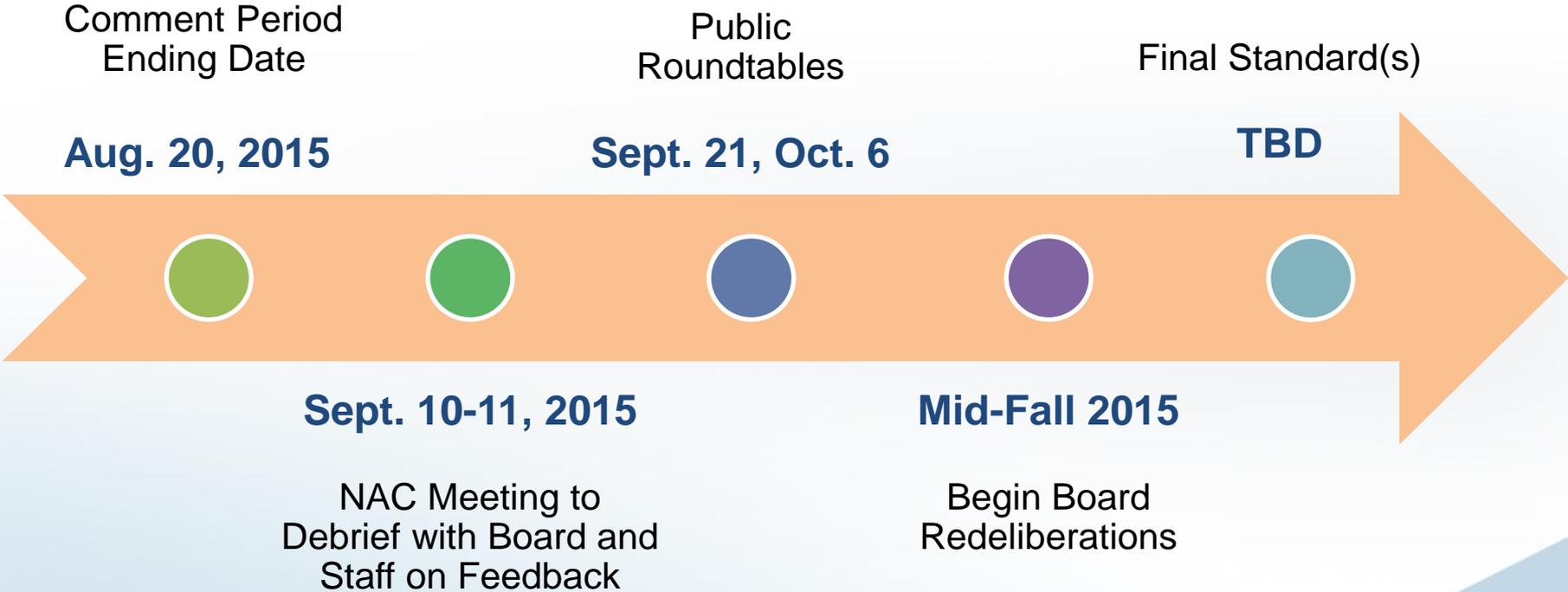
- Overall **disagreement** with proposed alignment of line items presented in cash flow statement with proposed operating classification for activities statement to increase understandability.
  - Especially regarding PP&E-related cash inflows/ outflows.
  - Most who disagree prefer current requirements to remain same until requirements change for business entities.
    - Inconsistency between NFP and for-profit reporting would create confusion for users who also operate in for-profit environment.

# Disclosures Useful for Assessing Liquidity

- **Mixed** feedback for proposed disclosures of information about liquidity.
  - More support for qualitative disclosures than quantitative disclosures.
  - Some who disagree express concern that:
    - “Time horizon” concept is vague and question how to choose one time horizon when multiple horizons and revenue streams exist.
    - Information will be outdated by time financial statements are issued.
    - Business entities not required to provide information proposed for NFPs.
    - Extensive disclosures reduce usefulness, and many users don’t read notes.
    - Disclosures too subjective, would result in inconsistent approaches among NFPs, reducing comparability.
    - Expected incremental benefits may not be greater than perceived cost of additional disclosures.
  
- **Common Suggested Alternatives:**
  - Require classified balance sheet.
  - Require separate presentation on balance sheet of assets whose use is limited.

# What Happens from Here?

# Project Timeline: Steps Still to Come





# Questions?



FINANCIAL  
ACCOUNTING  
STANDARDS BOARD