



New FASB Update for Not-for-Profits

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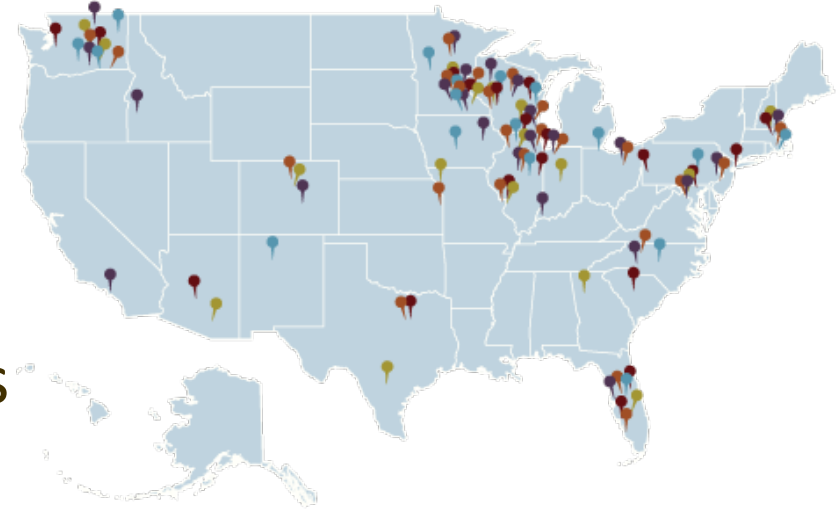
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- A professional services firm with three distinct business lines
 - Wealth Advisory
 - Outsourcing
 - Audit, Tax, and Consulting
- More than 4,500 employees
- Offices coast to coast
- More than 60 years of experience, serving more than 6,000 nonprofit clients



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Speaker Introductions

Cathy Clarke, Chief Assurance Officer

- More than 20 years of experience.
- Experience in conducting training sessions for audit and accounting staff within CLA and for the American Institute of CPAs.
- Current member of FASB's Not-for-Profit Advisory Committee

Chris Stanz, Principal

- More than 22 years of experience.
- Experience in nonprofit organizations requiring single audits, industry assurance technical resource, and compliance with professional standards and policies
- Current member of CLA's National Assurance Technical Group



Learning Objectives

At the end of this session, you will be able to:

- Discuss the new and pending changes to the FASB Not-for-Profit Reporting model
- Explain the new improvements to net asset classification requirements
- Describe changes to reporting of financial performance measures and expenses by function and nature
- Discuss improvements that will address misunderstandings in presentation of cash flows information



FASB: Financial Statements for Not-for-Profit Entities Timetable

- Exposure draft issued April 2015
- Comment Period and Re-deliberation complete
- Final Standard issued August 2016 on “YES” items
- Certain items moved to phase two project for further consideration
- THANK YOU to all who commented, your voice was heard!



Effective Dates and Transition

- Effective date: fiscal years “beginning” after December 15, 2017
 - 12/31/18 or 6/30/19
- Early application is permitted
- Application on a retrospective basis
- If comparative financial statements are presented option to omit the following for periods presented before the year of adoption:
 - Expenses by functional and natural classification
 - Disclosures about liquidity and availability of resources
- Year of application
 - Disclose nature of any reclassifications or restatements and their effects, if any, on changes in net assets classes for each year presented



Project Goals

- Update, not overhaul, the current model
- Provide more useful information to donors, grantors, creditors, and others
- Improve the current net asset classification requirements
- Improve the information presented in financial statements and notes about a NFPs liquidity, financial performance, expenses, and cash flows.
- Better enable NFPs to “tell their financial story”



Changes Intended to Address

- Complexities with the current three classes of net assets
- Inconsistencies in reporting of financial performance measures
- Deficiencies in transparency and utility of information regarding liquidity
- Inconsistencies in reporting of expenses by function and nature
- Misunderstandings in presentation of cash flows information



Two Phase Project:

Phase 1 – ASU 2016-14

- Net Assets
 - Classifications
 - Underwater endowments
 - Disclosures of board designations
 - Expirations of capital restrictions
- Investment Returns
 - Netting investment income and expenses and elimination of disclosure on netted expenses
- Expenses
 - Expenses by nature/analysis of functional expenses
 - Enhanced disclosures of cost allocations



Phase 1

- Operating measures
 - Modest improvements about disclosures, especially board appropriations, designations and other transfers
- Liquidity/Availability
 - Quantitative disclosures about availability
 - Qualitative disclosures about liquidity
- Statement of Cash Flows
 - Direct or Indirect method allowed; indirect reconciliation no longer required

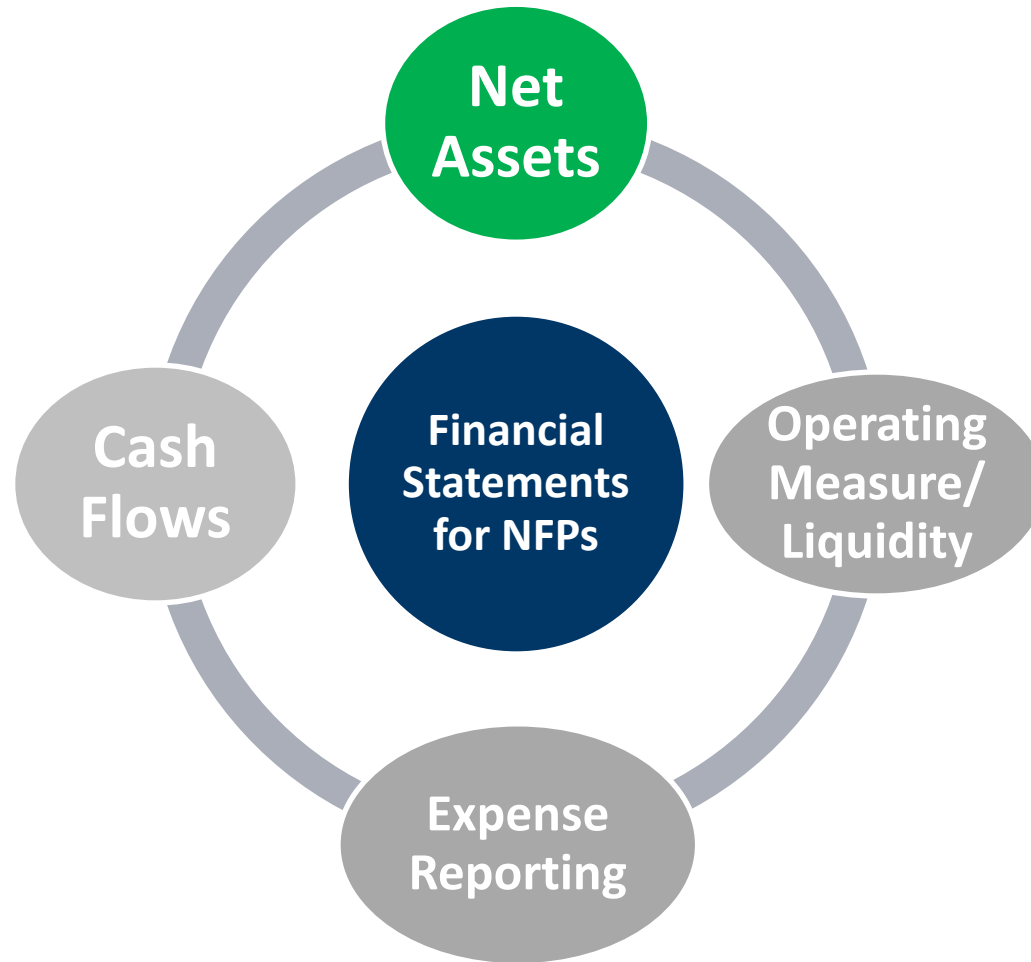


Phase 2

- Operating Measures
 - Whether to require intermediate measures
 - Whether and how to define such measures
 - Alternative disaggregation approaches
- Realignment of certain cash flow statement items
- Segment reporting as an alternative to an analysis of expenses by nature and function for business-oriented health care not-for-profits



FASB Presentation of Not-for-Profit Financial Statements



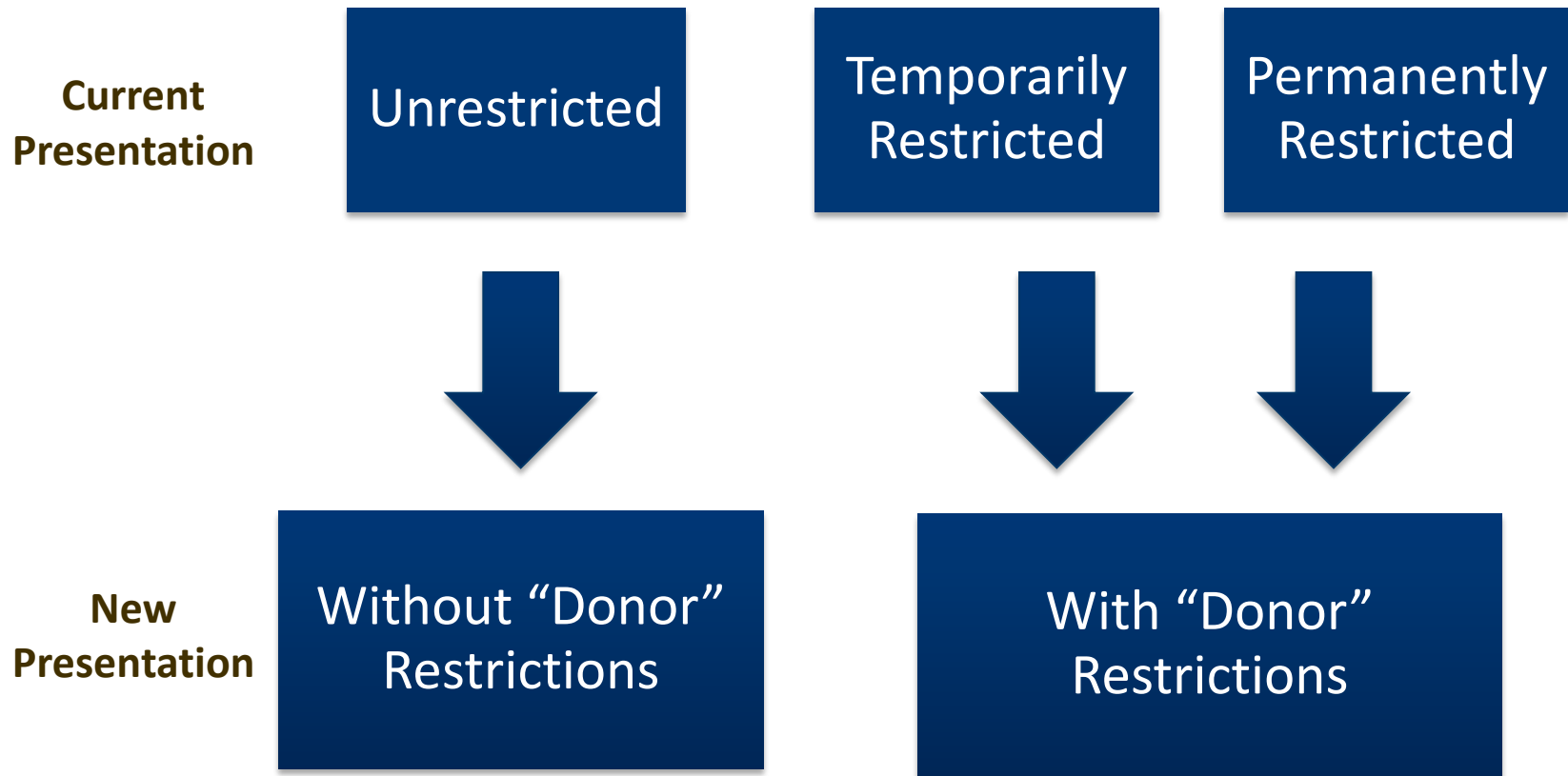
Net Assets Objectives

The new standard should address:

- Complexities with the current three classes
- Deficiencies in the transparency of information around restrictions
- Misunderstandings and confusion around the term “unrestricted net assets”



Two Net Asset Classes



Net asset classification requirement

- Two classes
 - Donor/grantor-imposed restrictions
 - Includes perpetual and temporary
 - Without donor/grantor-imposed restrictions
 - Includes board designated
- Disclosure requirement:
 - Composition of net assets with donor/grantor restrictions
 - Emphasis on how/when resources (net assets) can be used.
 - Specified purpose
 - Specified time
 - Perpetual (endowment)
 - Quantitative and qualitative information about board designations.



Net Asset Classification- Implementation

- Alternative disaggregation of net asset classes shown on the balance sheet

With donor restrictions:		
Perpetual in nature	\$XXX	
Purpose restricted	XXX	
Time-restricted only, for periods after 20X1	XXX	XXX
Without donor restrictions:		
Designated by the Board for [purpose]	\$XXX	
Undesignated	XXX	XXX
Net assets		\$XXX



Net Asset Disclosures – With Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes or periods

Subject to expenditure for specified purpose:

Program A activities:	
Purchase of equipment	\$ 1,530
Research	2,128
Educational seminars and publications	760
Program B activities:	
Disaster relief	1,120
Educational seminars and publications	1,079
Program C activities: general	1,484
Buildings and equipment	1,075
Annuity trust agreements for research	1,425
	<u>10,601</u>

Subject to the passage of time:

For periods after June 30, 20X1	<u>3,140</u>
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Subject to NFP spending policy and appropriation:

Investment in perpetuity (including amounts above original gift amount of \$22,337), the income from which is expendable to support:	
Program A activities	27,524
Program B activities	13,662
Program C activities	13,662
Any activities of the organization	105,793
	<u>160,641</u>

Subject to appropriation and expenditure when a specified event occurs:

Endowment requiring income to be added to original gift until fund's value is \$2,500	2,210
Paid-up life insurance policy that will provide proceeds upon death of insured for an endowment to support general activities	80
	<u>2,290</u>

Not subject to appropriation or expenditure:

Land required to be used as a recreation area	3,000
Total net assets with donor restrictions	<u>\$ 193,413</u>



Net Asset Disclosures – Without Donor Restrictions

The governing board of Not-for-Profit Entity A has several standing board policies that affect the presentation of board designations, appropriations, and other similar transfers on the statement of activities. Bequests without donor restrictions are designated for long-term investment (quasi-endowment); however, no bequests were received during 20X1. Occasionally the governing board designates a portion of its net assets without donor restrictions for its liquidity reserve; however, no amounts were added to the liquidity reserve during 20X1. Annually, the governing board appropriates portions of the quasi-endowment and donor-restricted endowments for current-period operations. During 20X1, a total of \$9,500 was appropriated and used, consisting of \$2,000 from the quasi-endowment and \$7,500 from donor-restricted endowments. Not-for-Profit Entity A placed \$1,640 of equipment into service during the year, which was funded with \$1,500 of donor-restricted funds that is shown as a release from restrictions, as well as \$140 of donated equipment. Both of these amounts are included in board designations, appropriations, and similar transfers on the statement of activities.

Not-for-Profit Entity A's governing board has designated net assets without donor restrictions for the following purposes as of June 30, 20X1.

Quasi-endowment	\$ 34,628
Liquidity reserve	1,300
Total	<u>\$ 35,928</u>



Expiration of Capital Restrictions

- Absent explicit donor stipulations
- Placed-in-service approach
 - Reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset
 - Reclassify amounts from net assets *with donor restrictions* to *without donor restrictions* for long-lived assets placed in service as of the beginning of the period of adoption
- Eliminates the option to release the donor-imposed restriction over the estimated useful life of the asset



Underwater Endowments

- Currently reported within unrestricted net assets.
- New reporting will be within “with donor restrictions” class of net assets.
- Disclose
 - Policy to reduce expenditures from underwater funds
 - Original gift of underwater funds (in aggregate)
 - Fair value of underwater funds (in aggregate)
 - Amount by which funds are underwater (in aggregate)



Underwater Endowments Disclosures

Underwater Endowment Funds

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires NFP A to retain as a fund of perpetual duration. NFP A has a policy that permits spending from underwater endowment funds depending on the degree to which the fund is underwater, unless otherwise precluded by donor intent or relevant laws and regulations.

As of June 30, 20X1, three donor-restricted endowment funds had aggregated original values totaling \$3,500, current fair values totaling \$3,300, and deficiencies totaling \$200. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new contributions for donor-restricted endowment funds and continued appropriation for certain programs that was deemed prudent by the Board of Trustees.



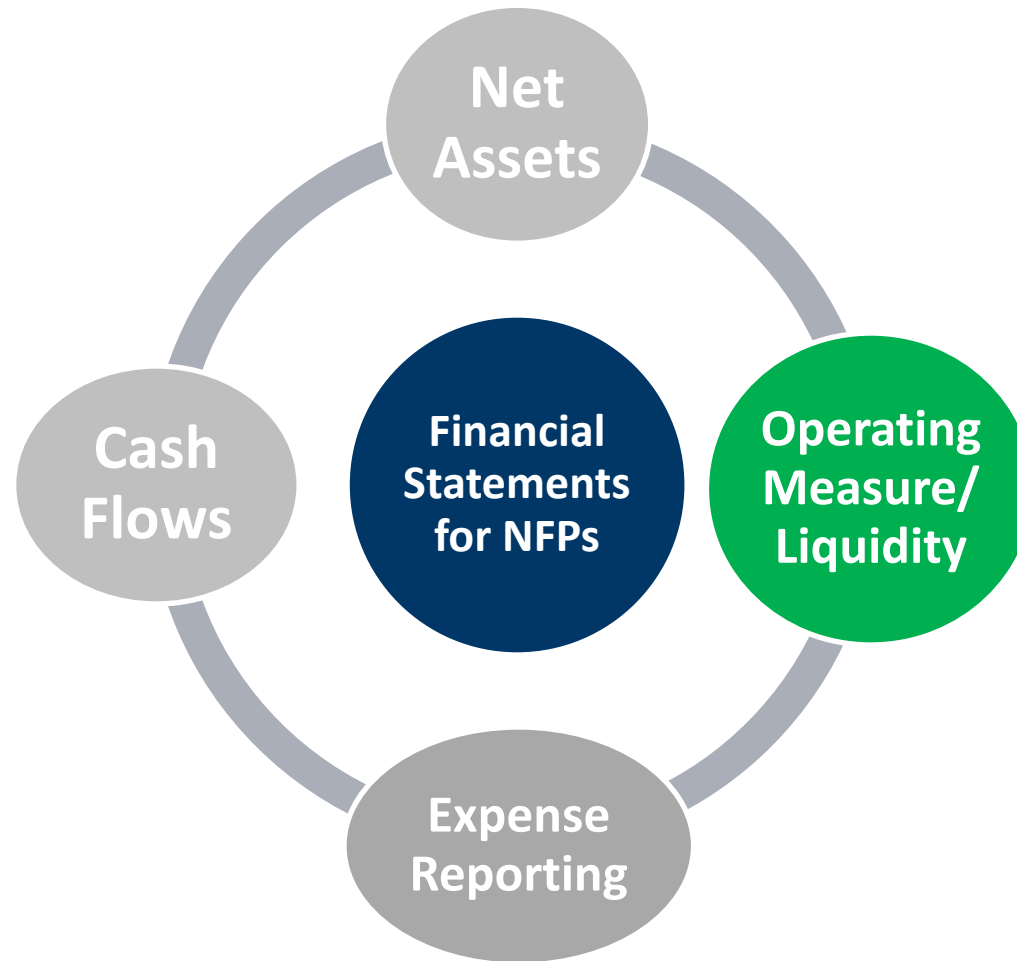
Impact of the Changes

Changes due to net assets classifications and disclosures are most likely to impact

- NFPs with endowments that are
 - Large
 - Relatively new
 - Have a significant number of underwater funds
 - NFPs with large quasi-endowment and other board-designated funds
 - NFPs that have significant capital assets



FASB Presentation of Not-for-Profit Financial Statements



Operating Measure/ Liquidity Objectives

- Provide transparency and utility of information provided to donors, grantors, creditors, and others in assessing an entity's liquidity
- Address inconsistencies in reporting of an intermediate measure of operations
- Improve comparability across all NFPs



Financial Performance – Intermediate Operating Measure

- Presentation will remain optional.
 - Disclosures required
 - If transfers between operating and non operating exist, required to disclose nature and amount in notes
- Performance Indicator in Health Care Entities – No change
- Phase 2 – define required intermediate operating measures for all NFPs based on mission and availability



Measure of Operations Disclosures

Measure of Operations

NFP A's operating revenues in excess of expenses and transfers includes all operating revenues and expenses that are an integral part of its programs and supporting activities, net assets released from donor restrictions to support operating expenditures, and transfers from Board-designated and other non-operating funds to support current operating activities. The measure of operations includes support for operating activities from both donor-restricted net assets and net assets without donor restrictions designated for long-term investment (the donor-restricted and quasi-endowment) according to NFP A's spending policy, which is detailed in Note X. The measure of operations excludes endowment support for non-operating activities, investment return in excess (less than) amounts made available for current support, gains and losses on extinguishment of debt, and changes in fair value of the interest rate swap. Included in the line item *transfer of funds, net* is investment return appropriated from quasi-endowment to operations of \$1,025, contributions designated by the Board of Trustees for capital projects from operations of \$3,000, and contributions and bequests designated by the Board of Trustees for quasi-endowment from operations of \$5,000.



Financial Statements – Liquidity Disclosures

- Qualitative Information
 - Financial assets available to meet near-term demands for cash, including demands resulting from near-term financial liabilities
- Quantitative Information
 - Face of Balance Sheet or Notes
- Availability of a financial asset may be affected by:
 - Its nature
 - External imposed limits
 - Internal imposed limits



Qualitative Liquidity Disclosures

NFP A utilizes a 60-day time horizon to assess its immediate liquidity needs. This period of time was established based on management's review of the typical life cycle of converting its financial assets to cash and typical payments of its trade payables. The entity invests cash in excess of daily requirements in short-term investments.

Occasionally the Board designates a portion of any operating surplus to its liquidity reserve. As of June 30, 20X1, the liquidity reserve was \$1,300. This is a governing board-designated fund with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, NFP A also could draw upon \$10,000 of available lines of credit (as further discussed in Note XX) or the quasi-endowment fund.



Quantitative Liquidity Disclosures

Financial assets, at year end	\$ 229,200
Less:	
Contractual or donor-imposed restrictions making financial assets unavailable for general expenditure	(192,413)
Quasi-endowment fund, primarily for long-term investing	(34,628)
Less amounts set aside for liquidity reserve:	<u>(1,300)</u>
Financial assets available within one year to meet cash needs for general expenditures within one year	<u>\$ 859</u>



Additional Example Disclosures

- The following quantitative and qualitative disclosures may supplement an unclassified balance sheet presentation.

958-210-55-7 NFP A has \$395,000 of financial assets available within one year of the balance sheet date consisting of cash of \$75,000, contributions receivable of \$20,000, and short-term investments of \$300,000. None of the financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the balance sheet date. The contributions receivable are subject to time restrictions, but will be collected within one year. NFP A has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately \$275,000. As part of its liquidity management, NFP A invests cash in excess of daily requirements in various short-term investments including certificate of deposits and short term treasury instruments. As more fully described in Note xx, NFP A also has committed lines of credit in the amount of \$20,000, which it could draw upon in the event of an unanticipated liquidity need.



Additional Example Disclosures

- The following qualitative disclosures may supplement a classified balance sheet presentation.

Note T

As part of NFP A's liquidity management, it invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of \$20 million which it could draw upon. Additionally, NFP A has a quasi-endowment of \$33 million. Although NFP A does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation, amounts from its quasi-endowment could be made available if necessary. However, both the quasi-endowment and donor endowment contain lock-up provisions that would reduce the total investments that could be made available.

NFP A's financial assets due within one year of the balance sheet date for general expenditure are as follows:

Cash and cash equivalents	\$ 4,575
Accounts and interest receivable	2,130
Contributions receivable	1,825
Short-term investments	1,400
Other investments appropriated for current use	1,650
	<u>\$ 11,580</u>

NFP A's endowment funds consist of donor endowment and quasi-endowment. Income from donor endowment is restricted for specific purposes and, therefore, is not available for general expenditure. The quasi-endowment has a spending rate of 5 percent. \$1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.



Investment Return

- Net presentation of investment expenses against investment return.
 - Both EXTERNAL and direct INTERNAL expenses
 - Removes requirement to disclose the gross investment income and expense (permitted but no longer required)



Defining Internal Investment Expenses

Involve the direct conduct or direct supervision of the strategic and tactical activities involved in **generating investment return.**

- Salaries, benefits, travel, and other costs associated with staff responsible for development and execution of investment strategy
- Allocable costs associated with internal investment management and supervising, selecting, and monitoring of external investment management firms
- DO NOT include items that are not associated with generating investment return such as costs associated with unitization and other such aspects of endowment management.



Impact of the Changes

Changes to the operating measures/liquidity are most likely to impact

- NFPs that present a performance measure
- All NFPs for the liquidity disclosures
 - Greater requirements for those who do not present a classified balance sheet
- NFPs that have large investment portfolios with internal investment expenses



FASB Presentation of Not-for-Profit Financial Statements



Expense Analysis

- Present an analysis of expenses by function and nature in one location (in the notes, in the statement of activities, or as a separate statement)
- Include a description of the method used to allocate costs among program and support functions
- Only operating expenses required to be functionalized
- Investment expenses netted against investment returns may be excluded
- Voluntary Health and Welfare entities no longer required to present a separate statement of functional expenses



Functional Expenses Defined

- Program Services

Activities that result in good and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists.



Functional Expenses Defined

- Supporting Activities

Supporting activities are all activities of an NFP other than program services.

i.e management and general activities, fundraising activities, and membership development activities



Supporting Activities

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than contributions and membership dues
- Disseminating information to inform the public of the NFP's stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report
- Recruiting and employee benefits activities (i.e. human resources)
- Expenses of the governing board
- Advertising



Analysis of Expenses

The table below presents operating expenses by both their nature and function for fiscal year 20X1.

	Program Activities				Supporting Activities			Total Expenses
	A	B	C	Programs	Management and General	Fund-Raising	Supporting	
Salaries and benefits	\$ 7,400	\$3,900	\$ 1,725	\$ 13,025	\$ 1,130	\$ 960	\$ 2,090	\$ 15,115
Grants to other organizations	2,075	750	1,925	4,750				4,750
Supplies and travel	865	1,000	490	2,355	240	560	800	3,155
Services and professional fees	160	1,490	600	2,250	200	390	590	2,840
Office and occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,440	800	570	2,810	250	140	390	3,200
Interest	196	109	77	382				382
Total expenses	\$13,296	\$8,649	\$ 5,837	\$ 27,782	\$ 2,038	\$2,150	\$ 4,188	\$ 31,970

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation, interest, and office and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits, which are allocated on the basis of estimates of time and effort.

Analysis of Expenses

- The analysis by nature and function could also be shown as an SOA breakout

Grant Activities:	
Salaries and benefits	\$ 1,808
Occupancy costs	970
Depreciation	845
Supplies	1,255
Other	56
	<hr/>
	4,934
Management and General:	
▶ Salaries and benefits	452
Occupancy costs	243
Depreciation	211
Supplies	314
Other	14
	<hr/>
	1,234
Total Expenses	<hr/> \$ 6,168



Example Disclosure

Note X. Methods Used for Allocation of Expenses from Management and General Activities

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is allocated based on a square footage basis, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on the benefit received, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

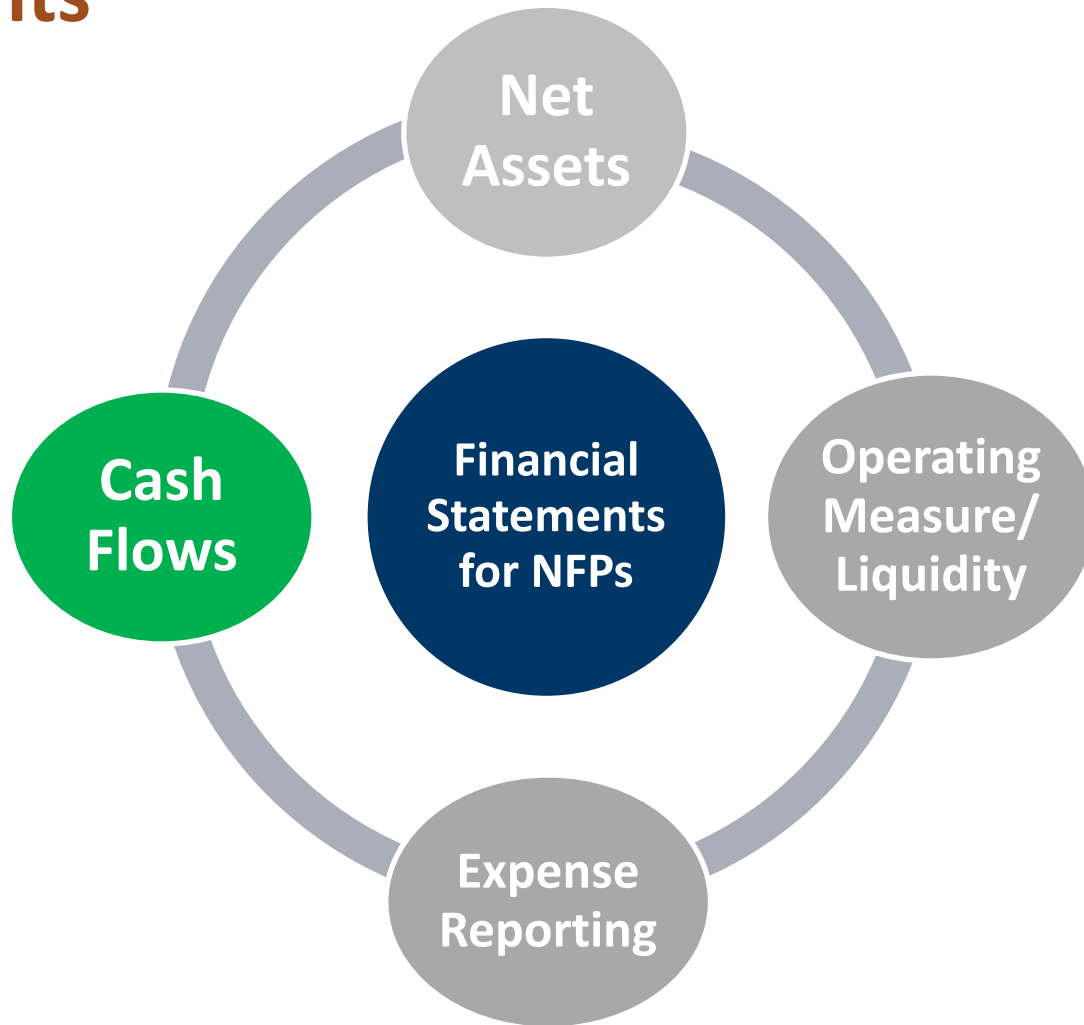


Impact of the Changes

- Changes to expense reporting are most likely to impact
 - NFPs that are not currently required to include a functional expense statement within their financial statements



FASB Presentation of Not-for-Profit Financial Statements



Statement of Cash Flow Objectives

- Improve the utility of the statement of cash flows
- Better align operating cash flows with operating measures in the statement of activities



Cash Flow Statement

- Can continue to use either direct or indirect method
- If use direct, no longer required to show indirect reconciliation
- Other proposed changes deferred to Phase 2
 - Reclassifications between type of activity (i.e. operating, investing and financing)
 - Alignment of Statement of Cash Flows with the Statement of Activities



Cash Flow Statement

Reconciliation of change in net assets to net cash used by operating activities:

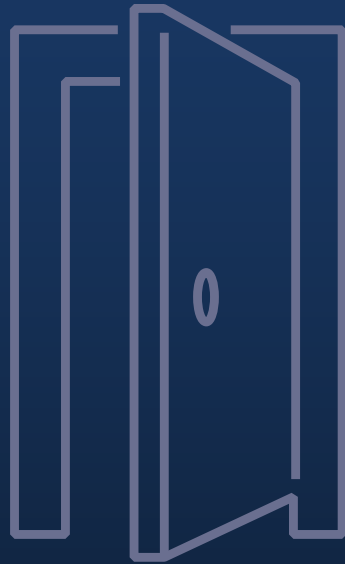
Change in net assets	\$ 15,450
Adjustments to reconcile change in net assets to net cash used by operating	
Depreciation	3,200
Fire loss	80
Actuarial loss on annuity obligations	30
Increase in accounts and interest receivable	(460)
Decrease in inventories and prepaid expenses	390
Increase in contributions receivable	(325)
Increase in accounts payable	1,520
Decrease in refundable advance	(650)
Decrease in grants payable	(425)
Contributions restricted for long-term investment	(2,740)
Interest and dividends restricted for long-term investment	(300)
Net unrealized and realized gains on long-term investments	(15,800)
Net cash used by operating activities	<u>\$ (30)</u>



Impact of the Changes

- Changes to cash flow reporting are most likely to impact
 - NFPs that are currently using the indirect method of reporting cash flows





Questions?

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