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Improvements to Not-for-Profit Financial Reporting



Background

- Financial Accounting Standards Board (FASB)
Not-for-Profit Advisory Committee (NAC)
- Studied areas for improving Generally
Accepted Accounting Principles (GAAP) for
NFPs
- ASU 2016-14 was issued August 18, 2016

Learning Objectives

- Review the changes for the new not-for-profit financial reporting standard
- Discuss how the changes impact financial statement presentation and your organization
- Highlight changes that are still under discussion
- Review the timing of the changes

Key Objectives of Standard

- Update, not overhaul, of the current model
- Provide better information to donors, grantors, creditors, and other users of the financial statements
- Improve on current net asset classification requirements
- Improve the presentation in the financial statements and disclosures about a NFPs liquidity, financial performance, expenses, and cash flows
- Enable NFPs to “better tell their financial story”

Problems the Standard Addresses

- Complexities with the current three net asset classes
- Deficiencies in the transparency and ability to assess an organization's liquidity
- Inconsistencies in the information provided about expenses
- Misunderstandings about the limited usefulness of the statement of cash flows

#1 - Change in Net Asset Classes

- Address complexities with the current three classes of net assets
- Address misunderstandings and confusion around the term “unrestricted net assets”
- Address deficiencies in the information provided on how restrictions imposed by donors, laws, and governing boards affect an NFP’s liquidity and classes of net assets

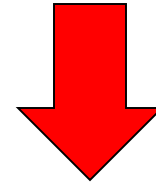
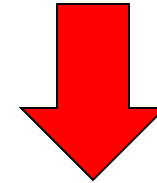
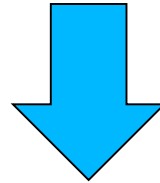
Two Net Asset Classes

Current
Presentation

Unrestricted

Temporarily
Restricted

Permanently
Restricted



New
Presentation

Without "Donor"
Restrictions

With "Donor"
Restrictions

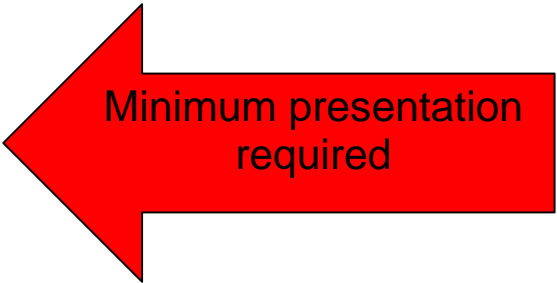
#1 - Change in Net Asset Classes

- Two classes
 - Without donor imposed restrictions
 - Includes board designated
 - Donor imposed restrictions
 - Includes perpetual and temporary
- Added disclosure requirements
 - Composition of net assets with donor restrictions
 - Emphasis on how/when net assets can be spent
 - Specified purpose
 - Specified time
 - Perpetual (endowment)
 - Quantitative information about board designations

Statement of Financial Position

Net assets:

Without donor restrictions	\$90,000
With donor restrictions	<u>110,000</u>



Minimum presentation
required

Total net assets	<u>\$200,000</u>
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Net assets:

Without donor restrictions -	
Undesignated	\$85,000
Designated by the Board for purpose	<u>5,000</u>
	90,000



Alternative
disaggregation allowed

With donor restrictions -	
Time restricted only, for periods after 2018	5,000
Purpose restricted	50,000
Perpetual in nature	<u>55,000</u>
	110,000

Total net assets	<u>\$200,000</u>
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Statement of Activities

	Without Donor Restrictions	With Donor Restrictions	Total
Revenue and other support:			
Contributions	\$ 8,600	\$ 8,400	\$ 17,000
Fees	5,200		5,200
Investment return, net	6,600	18,000	24,600
Other	300		300
Net assets released from restrictions	19,000	(19,000)	-
Total revenues and other support	39,700	7,400	47,100
Expenses:			
Program A	13,000		13,000
Program B	14,500		14,500
Management and general	2,000		2,000
Fundraising	2,000		2,000
Total Expenses	31,500	-	31,500
Change in net assets	8,200	7,400	15,600
Net assets at beginning of year	81,800	102,600	184,400
Net assets at end of year	\$ 90,000	\$ 110,000	\$ 200,000

Footnote Disclosure 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	\$ 5,500
Research	6,000
Educational seminars and publications	4,000

Program B activities:

Disaster relief	2,000
Educational seminars and publications	10,000

Program C activities: general

Buildings and equipment	2,000
Annuity trust agreements for research	10,500
	<u>10,000</u>
	50,000

Subject to the passage of time:

For the periods after December 31, 2018	5,000
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Subject to NFP's spending policy and appropriation

Investment in perpetuity including amounts above original gift amount of \$1,223,370, the income from which is expendable to support:

Program A activities	20,000
Program B activities	12,000
Program C activities	<u>23,000</u>
	55,000

Total Net Assets with Donor Restrictions

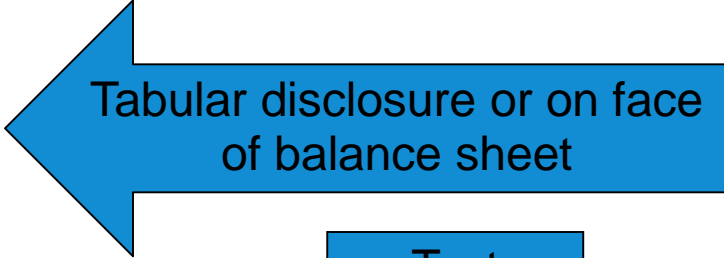
\$ 110,000

Board Designated Net Assets

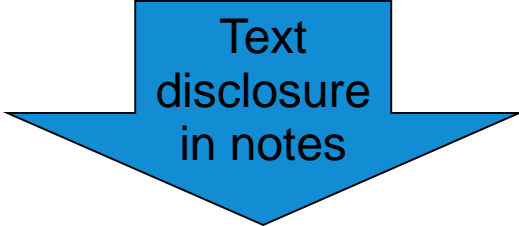
- New required disclosure of nature and amounts of board designations of net assets
- New FASB definition
 - Net Assets without donor restrictions subject to self-imposed limits by action of the governing board.
 - Board designated net assets may be earmarked for future programs, investment, contingencies, purchase or construction of fixed assets, or other uses.
 - Some governing boards may delegate designation decisions to internal management. Such designations are considered to be included in board designated net assets.
- Definition indicates a need for NFPs to have policies and/or practices regarding board designations on net assets

Disclosures for Board Designations

Undesignated	\$ 55,000
Quasi-endowment	30,000
Operating reserve	<u>5,000</u>
Total net assets	<u><u>\$ 90,000</u></u>



Tabular disclosure or on face
of balance sheet



Text
disclosure
in notes

Note 13 – Net Assets Without Donor Restrictions

The Board of Directors of XYZ Organization has several standing board policies that affect the presentation of board designations on net assets. Bequests without donor restrictions are designated for long-term investment (quasi-endowment). The quasi-endowment fund balance totaled \$30,000 at December 31, 20XX. Additionally, the Board of Directors has established an operating reserve with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need. The operating reserve balance totaled \$5,000 at December 31, 20XX.

#2 - “Underwater” Endowments

- Updated FASB definition:
 - Donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions.
- Report entire balance of endowment fund “with donor restrictions” class of net assets.
- Enhanced disclosures related to underwater funds

#3 - Donations/Contributions Restricted for Purchase of Property & Equipment

- No longer allowed to imply a time restriction, except if 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
- Eliminated the option to release the donor-imposed restriction over the estimated useful life of the asset
- Examples:
 - Donated vehicle
 - Capital campaign to build a new facility

#4 - Liquidity and Availability of Resources Disclosures

- Qualitative information on how a NFP manages its liquid resources available to meet cash needs for general expenditures within one year (in footnotes)
- Quantitative information that communicates the availability of the financial assets (cash, accounts receivable, investments) to meet cash needs for general expenditures within one year (on statement of financial position and/or in footnotes)
 - Availability may be affected by –
 - Nature of the assets
 - External limits imposed by donors, laws, and contracts with others
 - Internal limits imposed by board directors

Quantitative Availability Disclosure

Financial assets, at year end	\$ 148,000
Less:	
Contractual or donor-imposed restrictions making financial assets unavailable for general expenditure	(110,000)
Quasi-endowment fund, primarily for long-term investing	(30,000)
Less amounts set aside for liquidity reserve	<u>(5,000)</u>
Financial assets available within one year to meet cash needs for general expenditures within one year	<u>\$ 3,000</u>

Qualitative Liquidity Disclosures

- The Board periodically designates a portion of any operating surplus to its liquidity reserve. As of December 31, 20XX, the liquidity reserve was \$5,000. 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 also could draw upon \$50,000 of available lines of credit (as further discussed in Note XX) or the quasi-endowment fund of \$30,000.

Additional Liquidity Disclosures

- The following quantitative and qualitative disclosures may supplement an unclassified balance sheet presentation
- NFP has \$148,000 of financial assets available within one year of the balance sheet date consisting of cash of \$30,000, contributions receivable of \$55,000, and short-term investments of \$63,000. 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 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 \$75,000. As part of its liquidity management NFP 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 also has, committed lines of credit in the amount of \$50,000, which it could draw upon in the event of an unanticipated liquidity need.

#5 - Expense Reporting

- Present an analysis of expenses by function and nature in one location
 - May be presented in notes, in the statement of activities, or as a separate statement
 - Disaggregation of functional expense classifications by their natural expense classifications
 - Voluntary Health and Welfare entities no longer required to present a separate statement of functional expenses
- Include a description of the method used to allocate costs among program and support functions
- Improved guidance about management and general expenses

Analysis of Expenses

➤ Presentation in the notes or in a separate statement

	Program A	Program B	Program Subtotal	Management & General	Fund- Raising	Supporting Subtotal	Total Expenses
Salaries, benefits, and taxes	\$ 7,400	\$ 4,900	\$ 12,300	\$ 1,130	\$ 900	\$ 2,030	\$ 14,330
Grants to other organization	2,070	2,700	4,770				4,770
Supplies and travel	600	1,500	2,100	200	500	700	2,800
Services and professional fees	160	3,000	3,160	200	340	540	3,700
Office and occupancy	1,160	1,000	2,160	200	100	300	2,460
Depreciation	1,440	1,300	2,740	250	140	390	3,130
Interest	170	100	270	20	20	40	310
Total Expenses	<u>\$ 13,000</u>	<u>\$ 14,500</u>	<u>\$ 27,500</u>	<u>\$ 2,000</u>	<u>\$ 2,000</u>	<u>\$ 4,000</u>	<u>\$ 31,500</u>

Analysis of Expenses

➤ Presentation on the face of the Statement of Activities

Expenses:

Grant activities -

Grants	4,770
Salaries, benefits, and tax	12,300
Occupancy costs	2,160
Depreciation	2,740
Supplies	2,100
Other	3,430
	<u>27,500</u>

Management and general -

Salaries, benefits and taxes	1,130
Occupancy costs	200
Depreciation	250
Other	420
	<u>2,000</u>

Fundraising

Salaries, benefits and taxes	900
Other	1,100
	<u>2,000</u>

Total Expenses	<u><u>31,500</u></u>
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Disclosures of Allocation Methods

Note 5 - Methods Used for Allocation of Expenses Among Program and Supporting Services

The financial statements report certain categories of expenses that are attributable to one or more program or supporting services of the Organization. Those expenses include depreciation, the Executive Director's office, communications department, and information technology department. Depreciation is allocated based on a square footage basis, the Executive Director's office is allocated based on a time and cost study of where efforts are made, certain costs of the communications department are allocated based on a cost study of where efforts are allocated based on the benefit received, and the information technology department is allocated based on a cost study of specific technology utilized.

Functional Expenses Defined

- Program Services
 - Activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists.
- Supporting Activities
 - Supporting activities are all activities of an NFP other than program services. Generally, they include the following:
 - Management and general activities
 - Fundraising activities
 - Membership development activities

Management and General Expenses

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than contributions and membership dues
- Administering government, foundation, and similar customer-sponsored contracts, including billing and collecting fees and grant and contract financial reporting.
- Disseminating information to inform the public of NFPs stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report
- Employee benefits management and oversight (human resources)
- All other management and administration except for the direct conduct of program services, fundraising activities, or membership development activities.

Enhanced Guidance on M&G Allocation

- Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management & general activities
- Examples added:
 - IT – benefits various functions and generally would be allocated to program, fundraising, M&G
 - CEO – could be allocated to program, fundraising, M&G
 - CFO – could be allocated to M&G and investment expense
 - HR – generally would assign all to M&G
 - Grant Accounting and Reporting – program reports would be program (grant-related) but financial reports and related accounting would be M&G

#6 - Investment Return

- Present investment expenses net against investment return.
 - Both EXTERNAL and direct INTERNAL expenses
 - **Removes** requirement to disclose the gross investment income and expense (permitted but not required)

Defining Internal Investment Expenses

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

- Salaries, benefits, 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
- DOES NOT include items that are not associated with generating investment return such as costs associated with unitization and other such aspects of endowment management

#7 - Changes to Statement of Cash Flows

- 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

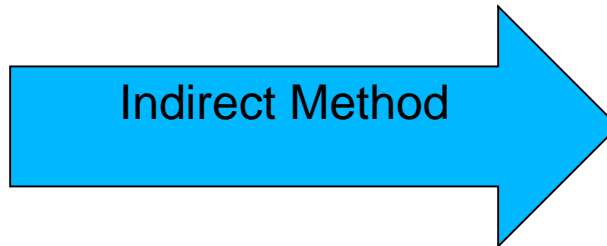
Operating Cash Flows - Which Presentation is More Informative?

Cash received from contributors	10,700
Cash received from service recipients	5,000
Interest and dividends received	8,600
Miscellaneous receipts	100
Cash paid to employees	(13,500)
Cash paid to suppliers	(5,700)
Interest paid	(400)
Grants paid	<u>(5,700)</u>
Net cash used by operating activities	<u>(900)</u>



Cash flows from operating activities:

Change in net assets	\$ 16,600
Adjustments to reconcile change in net assets to net cash	
Depreciation	3,000
Net gains on investments	(15,800)
Net gain on sale of equipment	(120)
Net change in operating assets and liabilities -	
Contributions receivable	(880)
Prepaid expenses and other assets	(460)
Accounts payable and accrued expenses	390
Grants payable	870
Contributions restricted for long-term investments	<u>(4,500)</u>
	<u>(17,500)</u>
Net cash used by operating activities	<u>(900)</u>



Effective Dates and Transition

- Effective Date:
 - Fiscal years beginning after 12/15/2017 (e.g. CY 2018 and FY 2018/2019)
 - Interim financials the following year
- Transition:
 - In year of adoption apply all provisions of the new ASU
- Required disclosures:
 - In year of adoption, disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for each period presented.
- Auditor's reports:
 - In year of adoption, include an emphasis-of-matter paragraph in the auditor's report if the adoption results in changes that have a material effect on the financial statements

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