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ACCOUNTANTS & ADVISORS

FASB PROJECT ON NOT-FOR-PROFIT FINANCIAL REPORTING: FINANCIAL STATEMENTS

The FASB is moving forward with the proposed ASU *Presentation of Financial Statements of Not-For-Profit Entities*. The proposed changes are considered to be the most sweeping changes since 1993.

After receiving 264 comment letters and holding three public roundtables, which representatives of Marks Paneth LLP participated in, the FASB Board decided to separate the project into two phases:

Phase I: Redeliberation of proposed changes not dependent on other projects and that are improvements the Board might finalize in the near term.

Phase II: Redeliberation of other proposed changes likely to require more time to resolve, because they:

- Involve consideration of alternatives suggested by stakeholders the Board did not previously consider, or
- Are related to similar issues being addressed in other FASB projects.

The following are the major changes that the FASB's Board has tentatively approved for Phase I:

Method of Presenting Statement of Cash Flows

The Board decided not to require not-for-profit entities (NFPs) to use the direct method of presenting the statement of cash flows, but instead to continue to allow them to use either the direct method or indirect method. Further, the Board decided to no longer require the indirect reconciliation if an NFP chooses to use the direct method.

The Net Asset Classification Presentation and Related Issues

1. Requirement of two classes of net assets:

The Board affirmed its proposal to combine temporarily and permanently restricted net assets into net assets *with donor restrictions* and to rename unrestricted net assets *net assets without donor restrictions*. Consistent with the proposed update, this alternative would retain the current U.S. GAAP requirement to provide relevant information about the nature and amounts of donor restrictions on net assets (either on the face of the statement of financial position or in the notes).

2. Disclosure of amounts and purposes of board-designated net assets:

The Board affirmed its proposal to require the disclosure of the amounts and purposes of board-designated net assets either on the face of the financial statements or in the notes.

3. Classification and disclosure of underwater endowments:

a. The Board affirmed its proposal to require that the aggregate amount by which endowment funds are underwater be classified within net assets with donor restrictions rather than the current unrestricted category.

b. The Board decided to affirm its proposal for endowment funds that are underwater, if any, to require the disclosure of:

- The NFP's policy to either reduce expenditure or not spend from underwater endowment funds
- The aggregate fair value
- The aggregate original endowment gift amount or level required by donor stipulations or by law to be maintained
- The aggregate of the amount of the deficiencies.

4. Requirement of placed-in-service approach and elimination of over-time approach for expirations of restrictions to acquire or construct long-lived assets:

The Board affirmed its proposal to require, in the absence of explicit donor instructions, the placed-in-service approach for expirations of restrictions to acquire or construct long-lived assets, thus eliminating the over-time approach.

Information Useful in Assessing Liquidity and Availability

The Board directed the FASB staff to explore an approach that would require, like the proposal, qualitative information about how the NFP manages its liquidity and liquidity risks, but provide alternative ways of presenting quantitative information. This approach would emphasize information about assets that are liquid and available at the balance sheet (or statement of financial position) date.

The FASB staff sought tentative decisions to clarify the proposed ASU objective of the qualitative and quantitative disclosures of information useful in assessing liquidity and availability.

The Board approved the following two objectives:

I. The objective is to communicate qualitative information about how a NFP manages its liquid resources available to meet near-term cash needs for general expenditures and its exposure to liquidity risks, and

II. Qualitative and quantitative information useful in assessing the availability of a NFP's liquid resources at the balance sheet (or statement of financial position) date to meet near-term cash needs for general expenditures considering external limits imposed by donors, laws and contracts with others, and internal limits imposed by governing board decisions.

Netting of External and Direct Internal Investment Expenses against Investment Return

The Board affirmed the proposal to require the netting of external and direct internal (e.g. chief investment officer) investment expenses against investment return. The Board also directed the staff to provide implementation guidance to illustrate what activities constitute direct internal investing activities. The Board also decided not to require that NFPs disclose internal salaries and benefits that are netted against investment return.

Expenses by Nature and Analysis of Expenses by Function and Nature

NFPs are currently required to report expenses by function (program & supporting services) under paragraph 958-720-45-2 of the FASB *Accounting Standards Codification*. The proposed ASU did not propose to change these requirements. However, the FASB Board at their February 3, 2016 meeting, asked the FASB staff to perform additional investigation and outreach regarding this requirement for health care and other business-oriented NFPs.

The FASB staff presented the results of their investigation and outreach and the FASB Board approved to retain the current requirements for all NFPs to report expenses by function.

The Board also affirmed the proposal to require all NFPs to disclose expenses by natural classification (salaries, occupancy, etc.). The Board also directed the staff to explore whether to exclude certain business-like NFPs from the current requirement to report expenses by function before considering whether to require an analysis of expenses by function and nature.

The proposed ASU would require all NFPs to provide in one location a disclosure of all expenses other than netted investment expenses. The proposed ASU would allow NFPs the flexibility to provide this information either on the face of the statement of activities, in a separate statement (such as a statement of functional expenses), or in the notes.

Enhanced Disclosures about Cost Allocations and Improved Guidance on Management and General Activities

The Board affirmed the proposal to require NFPs to provide enhanced disclosures about the method(s) used to allocate costs among program and support functions. The Board also affirmed the proposal to refine the FASB Accounting Standards Codification® definition of management and general activities and to provide additional implementation guidance to better depict the types of costs that can be allocated among program and/or support functions and those that should not be allocated.

Operating Measure Disclosures

As part of Phase 1, the Board directed the FASB staff to look into any improvements that could be made to the disclosures for a NFP that currently chooses to present an operating measure in its statement of activities.

The FASB staff presented to the Board several alternatives and the Board approved that for NFPs that choose to present a self-defined operating measure it will be required to add explicit requirements to report transfers (in and out of the operating measure) appropriately disaggregated and described by type, either on the face of the financial statements or in the notes.

Transition

The Board decided that NFPs should apply the amendments on a retrospective basis for all years presented. They also decided to permit early adoption.

Effective Date

The Board decided that the amendments would be effective for financial statements for fiscal years beginning after December 15, 2017, and for interim financial statements for periods after that date. In other words, calendar 2018 and fiscal 2019 year ends.

Next Steps

The ASU for Phase I is expected to be issued in the third quarter of 2016.

For more information

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