

# The New NFP Financial Reporting Standard

What you need to know



# The New Not-for-Profit Standard ASU 2016-14

## □ Overview

### Key Changes

- Net Asset Classes
  - Investment Return
  - Statement of Cash Flows
  - Expense Reporting
  - Liquidity and Availability
- Phase II – What's next?





# Overview – ASU 2016-14

What is Accounting Standards Update 2016-14?

# What you need to know about ASU 2016-14

## What is ASU 2016-14?

- ASU 2016-14 was issued by the Accounting Standards Board (FASB) on August 18, 2016.
- ASU 2016-14 presents a new not-for-profit reporting model to serve as an update to the current reporting standards, issued in 1993.
- ASU 2016-14 aims to improve information in financial statements and notes, allowing NFP organizations to better tell their story.

# What you need to know about ASU 2016-14

## When is ASU 2016-14 effective?

- Effective for annual financial statements issued for fiscal years beginning after December 15, 2017
  - Calendar year ended December 31, 2018
  - Fiscal years ending in 2019
  
- Early adoption is allowed but all provisions must be applied.

# Form 990 Implications

## Will anything change on form 990?

- Internal Revenue service has not yet updated the form 990, Return of Organization Exempt from Income Tax
- AICPA's Exempt Organizations Taxation Technical Resource Panel sent a letter to the Internal Revenue Service requesting updates

# Purpose of ASU 2016-14

## ➤ 3 initial subgroups formed to address:

- Reporting on financial performance through the statement of activities and statement of cash flows
- Other means of financial communications for telling an NFP's story beyond the financial statements
- Reporting on financial health, including liquidity through the statement of financial position, notes, or both



## ➤ 4 additional subgroups added to address:

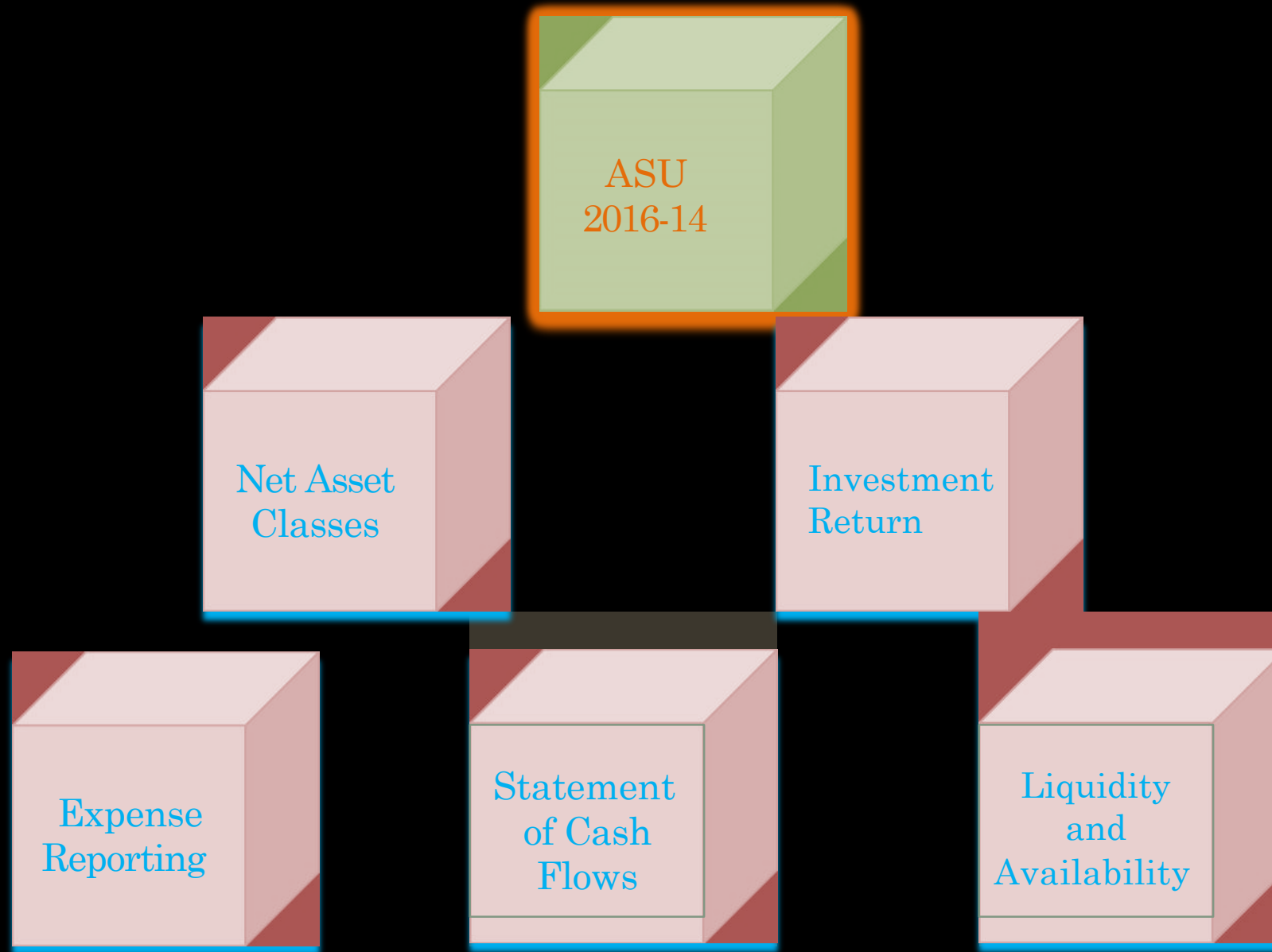
- Improve current net asset classification scheme
- Improve statements of activities and cash flows to more clearly communicate financial performance
- Develop a framework for directors and management to provide commentary and analysis about financial health, operations, and liquidity
- Streamline footnote disclosures and improve relevance and understandability



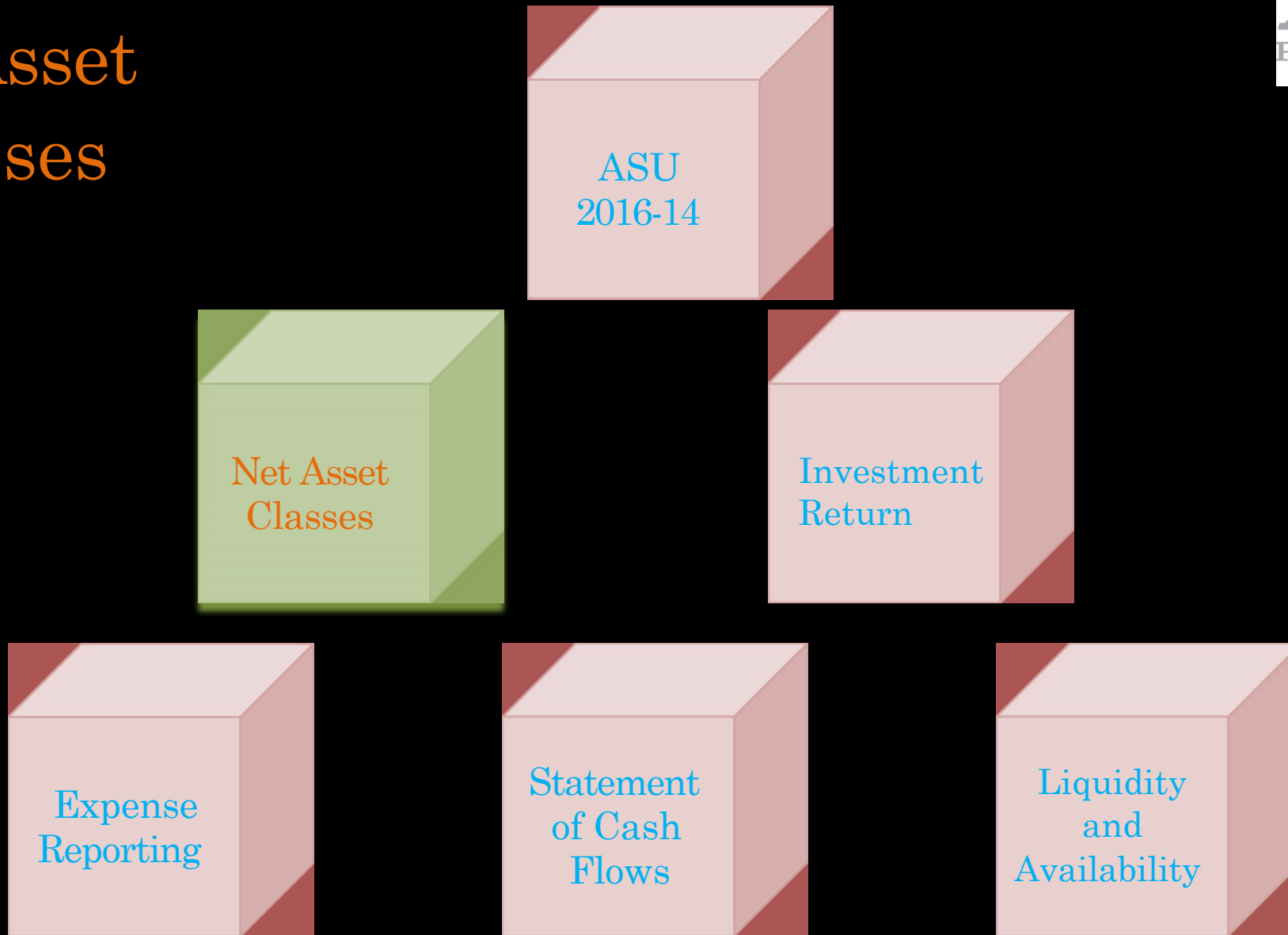
# Key Changes – ASU 2016-14

How will the key changes effect your organization?





# Net Asset Classes



**Current  
GAAP**

Unrestricted	Temporarily Restricted	Permanently Restricted
Without Donor Restrictions	With Donor Restrictions	
Amount, purpose and type of board designation	Nature and Amount of Donor Restrictions	

## Net Asset Classes

Currently NFP's are required to disclose three categories of net asset restrictions—unrestricted, temporarily restricted, and permanently restricted.

# Why the change?

- Improve Financial reporting in several ways
  - ❖ Combination of temporary and permanent restrictions will reduce complexity
  - ❖ Changes in laws have made lines between the two restricted classes unclear
  - ❖ Footnote disclosure can more effectively provide details and relevant information
  - ❖ Provide clarity for creditors, donors, grantors in regard to restricted assets

Changes in Statement of Activities

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total		Without Donor Restriction	With Donor Restriction	Total
Public support and revenue					Public support and revenue			
Public support					Public support			
Cash contributions	\$ 300,000	\$ 50,000	\$ -	\$ 350,000	Cash contributions	\$ 300,000	\$ 50,000	\$ 350,000
Special events, net	500,000	-	-	500,000	Special events, net	500,000	-	500,000
<b>Total public support</b>	<b>800,000</b>	<b>50,000</b>	<b>-</b>	<b>850,000</b>	<b>Total public support</b>	<b>800,000</b>	<b>50,000</b>	<b>850,000</b>
Revenue					Revenue			
Rental revenue	20,000	-	-	20,000	Rental revenue	20,000	-	20,000
Gain (loss) on endowment		(5,000)	-	(5,000)	Gain (loss) on endowment	-	(5,000)	(5,000)
<b>Total revenue</b>	<b>20,000</b>	<b>(5,000)</b>	<b>-</b>	<b>15,000</b>	<b>Total revenue</b>	<b>20,000</b>	<b>(5,000)</b>	<b>15,000</b>
Net assets released from restrictions	15,000	(15,000)	-	-	Net assets released from restrictions	15,000	(15,000)	-
Total public support and revenue	835,000	30,000	-	865,000	Total public support and revenue	835,000	30,000	865,000
Expenses					Expenses			
Program services	500,000	-	-	500,000	Program services	500,000	-	500,000
Supporting services					Supporting services			
Management and general	150,000	-	-	-	Management and general	150,000	-	150,000
Development and community support	75,000	-	-	-	Development and community support	75,000	-	75,000
<b>Total supporting services</b>	<b>225,000</b>	<b>-</b>	<b>-</b>	<b>225,000</b>	<b>Total supporting services</b>	<b>225,000</b>	<b>-</b>	<b>225,000</b>
<b>Total expenses</b>	<b>725,000</b>	<b>-</b>	<b>-</b>	<b>725,000</b>	<b>Total expenses</b>	<b>725,000</b>	<b>-</b>	<b>725,000</b>
<b>Change in net assets</b>	<b>110,000</b>	<b>30,000</b>	<b>-</b>	<b>140,000</b>	<b>Change in net assets</b>	<b>110,000</b>	<b>30,000</b>	<b>140,000</b>
<b>Net assets at beginning of year</b>	<b>1,000,000</b>	<b>100,000</b>	<b>200,000</b>	<b>1,300,000</b>	<b>Net assets at beginning of year</b>	<b>1,000,000</b>	<b>300,000</b>	<b>1,300,000</b>
<b>Net assets at end of year</b>	<b>\$ 1,110,000</b>	<b>\$ 130,000</b>	<b>\$ 200,000</b>	<b>\$ 1,440,000</b>	<b>Net assets at end of year</b>	<b>\$ 1,110,000</b>	<b>\$ 330,000</b>	<b>\$ 1,440,000</b>

# Changes in Statement of Activities

## Nonprofit ABC Statement of Activities Year ended June 30, 20X1

Net assets without donor restrictions	
Total revenues and gains	\$ 20,000
Net assets released from restrictions	15,000
Total expenses and losses	(30,000)
Increase in net assets without donor restrictions	<u>5,000</u>
Net assets with donor restrictions	
Contributions	9,000
Investment return, net	18,000
Actuarial loss on annuity trust obligations	(1,000)
Net assets release from restrictions	(15,000)
Increase in net assets with donor restrictions	<u>11,000</u>
Increase in net assets	16,000
Net assets at beginning of year	<u>200,000</u>
Net assets at end of year	\$ 216,000

What is this number  
made up of?  
Additional disclosure  
required

# Net Asset Disclosure Requirements

## ➤ Board Designated Funds

- Amounts and purposes of governing board designations
- Appropriations and similar actions that result in self-imposed limits on the use of resources
- Internal limits imposed by actions of the governing board

## ➤ Donor Restricted Funds

### ❖ Net Assets earmarked for:

- Future programs
- Investment
- Contingencies
- Purchase or construction of fixed assets
- Purchase of other assets

## In Practice Net Assets Note Disclosure

### Subject to expenditure for specific purpose:

#### Program A activities:

Purchase of equipment	\$ 3,060
Research	950
Education seminars and publications	240

#### Program B activities :

Disaster relief	745
Education seminars and publications	280

#### Program C activities : general

Buildings and equipment	2,150
Annuity trust agreements for research	2,815
	10,450

Program  
Restricted

### Subject to passage of time:

For periods after December 31, 20XX	3,140
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Time  
Restricted

### Subject to NFP spending policy and appropriation: passage of time:

Investment in perpetuity (including amount above original gift amount of \$122,337),  
Which, once appropriated, is expendable to support:

Program A activities	33,300
Program B activities	15,820
Program C activities	16,480
Any activities of the organization	109,100
	174,700

Endowment  
Restrictions/  
Appropriations

### 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	2,120
Paid-up life insurance policy that will provide proceeds upon death of insured for an endowment to support general activities	80
	2,200

Purpose  
Restricted

### Not subject to appropriation or expenditure:

Land required to be used as a recreation area	3,000
Total net assets with donor restrictions	\$ 193,490

*In Practice*  
**Net Asset  
Note  
Disclosure**

**Note X, Board Designations**

NFP Entity A is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, NFP Entity A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure in one year. Occasionally, the **board designates a portion of any operating surplus** to its liquidity reserve, which **was \$15,000 as of June 30, 20X1**. This is a fund established by the governing board that **may 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.

# Underwater Endowments

## ➤ Old GAAP:

- Underwater endowments are offset against unrestricted net assets.

## ➤ New GAAP:

- Underwater endowments are offset against assets with donor restrictions.

## Enhanced disclosure requirements

- NFP's endowment policy and any changes made to it during the period
- Aggregate fair value of the endowed fund
- Aggregate amount of original gifts
- Aggregate amount by which funds are underwater

# Net Asset Classifications Management Considerations

- Are Current classifications appropriate?
  - Review current classifications
  - Review current board designations
- Does the Organization have underwater endowments?
  - Identify the underwater funds
  - Reaffirm spending policies for underwater endowments
- What is the best financial statement presentation for the organization?
  - Determine format and level of detail on face of statement
  - Consider terminology changes
- How will the Organization address new disclosures?
  - Determine level of detail to be included in footnotes
  - Determine if any internal system /process changes will be required

# Net Asset Classifications

## Board Discussions

- Explain the new net asset categories
  - Review terminology changes
  - Illustrate how the changes will affect statement presentation
  - Describe any impact on underwater endowments on net asset balances
- Reaffirm and assess prior board designations and spending
- Discuss additional costs associated with changes
  - Additional audit fees
  - System and or process changes

# Investment Return

ASU  
2016-14

Net Asset  
Classes

Investment  
Return

Expense  
Reporting

Statement  
of Cash  
Flows

Liquidity  
and  
Availability



# Investment Return

Currently NFP's are required to disclose components of investment return including investment income, gains and losses, and any netted expenses

# Investment Return Requirements

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## ❖ Current Requirements

- Two options for presenting investment expenses on the statement of activities:
  - Netted against investment return
  - Presented as a component of expenses
- All NFPs are required to disclose the components of investment return including investment income, gains and losses, and any netted investment expenses

## ❖ New Requirements

- Required to report all external and direct internal investment expenses netted against investment return on the statement of activities
  - External – Amounts paid to third parties to generate investment returns
  - Direct Internal – direct conduct or supervision of strategic and tactical activities to generate investment returns
- Eliminated requirement to disclose:
  - Composition of investment return
  - Amount of investment expenses

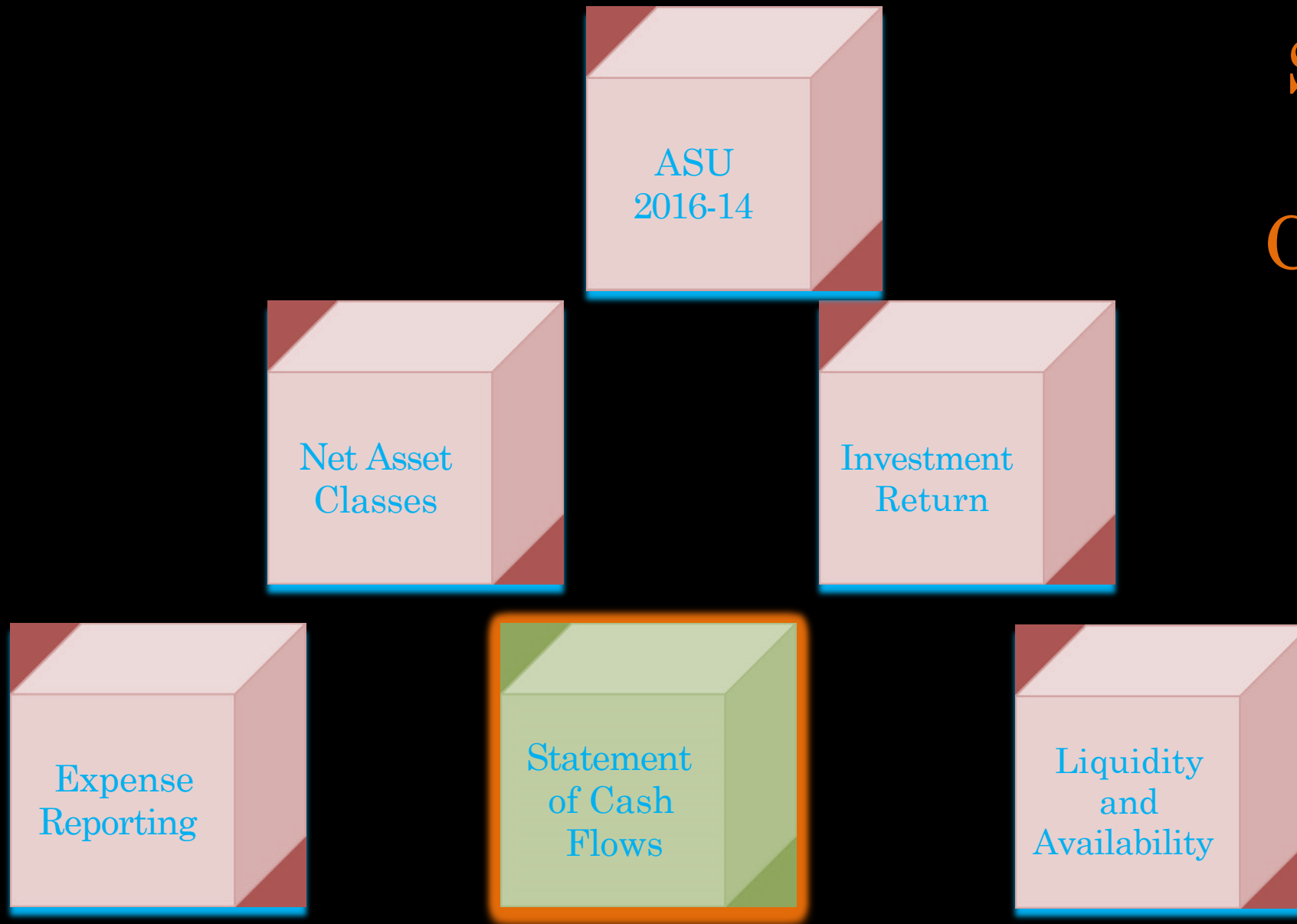
# Investment Returns Management Considerations

- Identify costs, if any, that are being netted
- Evaluate which costs are appropriate under new guidance
- Consider how to communicate any material changes
- Decide if reports outside the financial statement should be changed for consistency

# Investment Returns Board Discussions

- Explain the new requirements
- Identify differences in amounts that will be netted
- Discuss any implications of changes in balances

# Statement of Cash Flows





# Statement of Cash Flows

NFPs can continue to choose between the Direct Method and Indirect Method in presenting cash flows from operating activities.

## Operating Cash Flows

### Indirect Method vs Direct Method

Indirect Method		Direct Method	
Cash flows from operating activities		Cash flows from operating activities	
Change in net assets	\$ 700,000		
Adjustments to reconcile change in net assets to net cash provided by operating activities		Cash received from service recipients	\$ 50,000
Depreciation and amortization	15,000	Cash received from contributors	100,000
Decrease in receivables	5,000	Cash collected on promises to give	5,000
Decrease in other assets	5,000	Interest and dividends received	2,000
Decrease in accounts payable and accrued expenses Net	(20,000)	Miscellaneous Receipts	500
		Cash paid to employees	(50,000)
Net realized and unrealized gain on investment	(10,000)	Cash paid to suppliers	(30,000)
Total adjustments	(5,000)	Interest paid	(5,000)
Net cash provided by operating activities	695,000	Grants paid	(50,000)
		Net cash provided by operating activities	\$ 22,500
Cash flows from investing activities			
Purchase of equipment	(50,000)		
Net cash used by investing activities	(50,000)		
Net increase in cash and cash equivalents	645,000		
Cash and cash equivalents at beginning of year	100,000		
Cash and cash equivalents at end of year	\$ 745,000		

The change allows an organization to select the presentation method that best serves the needs of the entity. Allows greater flexibility in financial reporting and a potential reduction in time and effort used to prepare the financial statements.

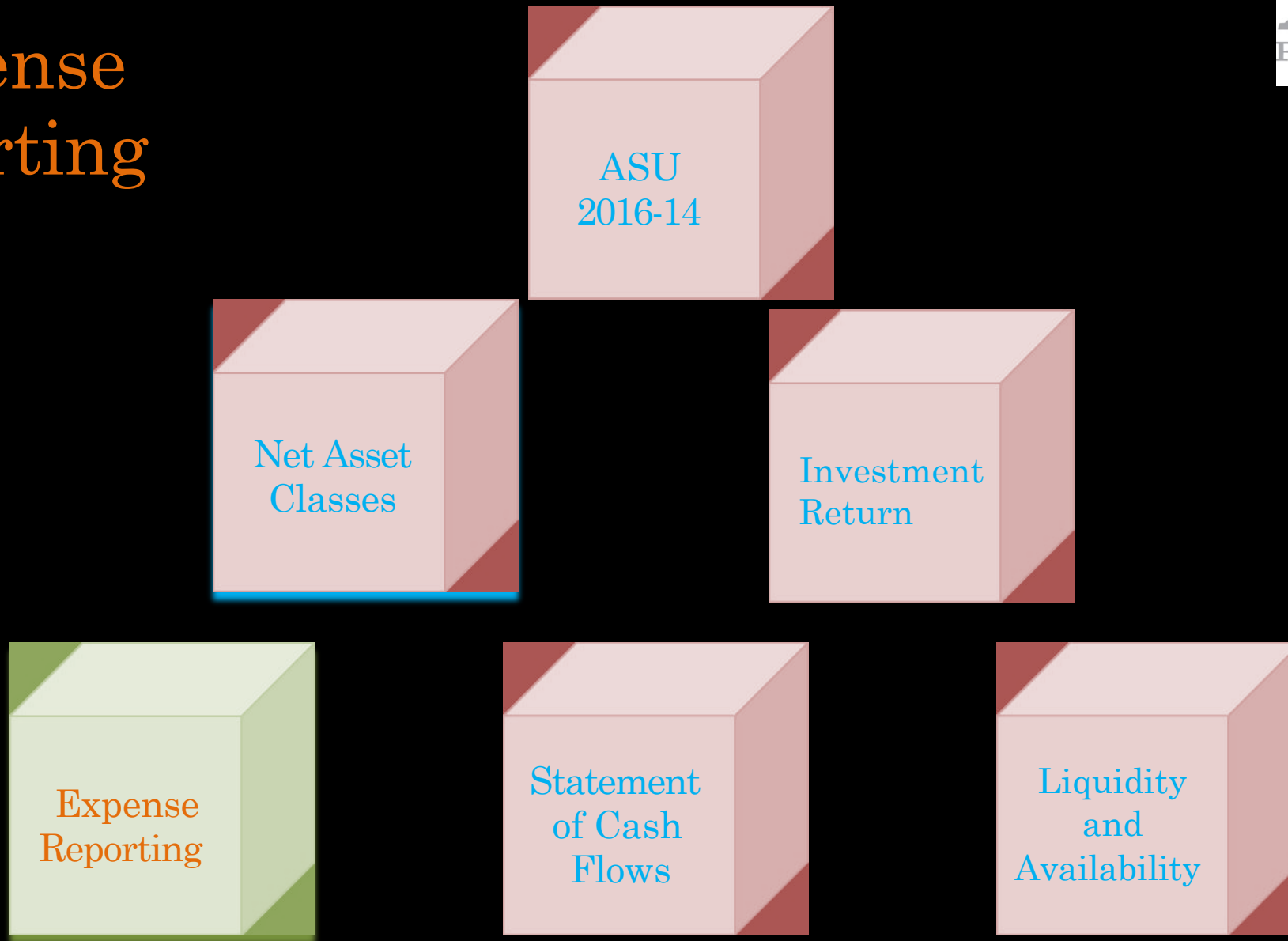
# Cash Flow Statement Management Considerations

- ❑ Which presentation is best for your Organization?
- ❑ If contemplating a change, consider:
  - Recasting your most recent statement in the new format
  - Determining if any financial system changes are necessary
  - Determining if any process changes will be needed

# Cash Flow Statement Board Discussions

- Review pros and cons of each method
- Prepare statements using each method
- Highlight differences in each method
- Identify any additional costs associated with the change

# Expense Reporting





# Expense Reporting

All NFPs now required to present a statement of functional expense as well as provide additional footnote disclosure.

# Functional Expense Reporting

- ❑ ASU 2016-14 requires **all not-for-profits** to report expenses by both **functional** and **natural** classification
  - Previously only voluntary health and welfare organizations required to report expenses by function
  - Now required to disclose an analysis of expenses and qualitative disclosures about the methods used to allocate costs
  - New guidance relating to Management and General Expenses issued

# Functionalization of Expenses

Program  
Services

Supporting Services

Management  
and General

Fundraising  
Activities

Membership  
Development  
Activities

	Program Service	Management and General	Fundraising	Total
Salaries and benefits	\$ 550,000	\$ 125,000	\$ 40,000	\$ 715,000
Grants to individuals	100,000	-	-	100,000
Professional fees	-	24,500	-	24,500
Advertising	100	100	10,000	10,200
Office Expenses	8,000	8,000	2,000	18,000
Telephone	4,500	750	2,000	7,250
Postage and shipping	4,000	500	1,000	5,500
Printing and reproduction	2,000	750	3,000	5,750
Information technology	40,000	10,000	5,000	55,000
Occupancy	50,000	10,000	7,500	67,500
Licenses	500	3,000	250	3,750
Insurance	7,500	2,000	1,000	10,500
Travel	1,500	750	5,000	7,250
Bank fees	-	1,000	1,500	2,500
<b>Total expenses before deprecitaion</b>	<b>768,100</b>	<b>186,350</b>	<b>78,250</b>	<b>1,032,700</b>
Depreciation	12,000	2,000	1,500	15,500
<b>Total expenses</b>	<b>\$ 780,100</b>	<b>\$ 188,350</b>	<b>\$ 79,750</b>	<b>\$ 1,048,200</b>

## THE FINANCIAL STATEMENT AND FUNCTIONALIZATION OF EXPENSES

Fundraising

Management and  
General

Program Service

# Required Disclosures - Example

## Qualitative Description of the Methods Used

### ❖ 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 square footage, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

# Improved Guidance Management and General Expenses

M&G - Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities.

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing
- Soliciting funds other than contributions
- Producing and distributing the annual report

Positions generally allocated include:

- CEO
- CFO
- IT
- Human Resources
- Grant Accountant

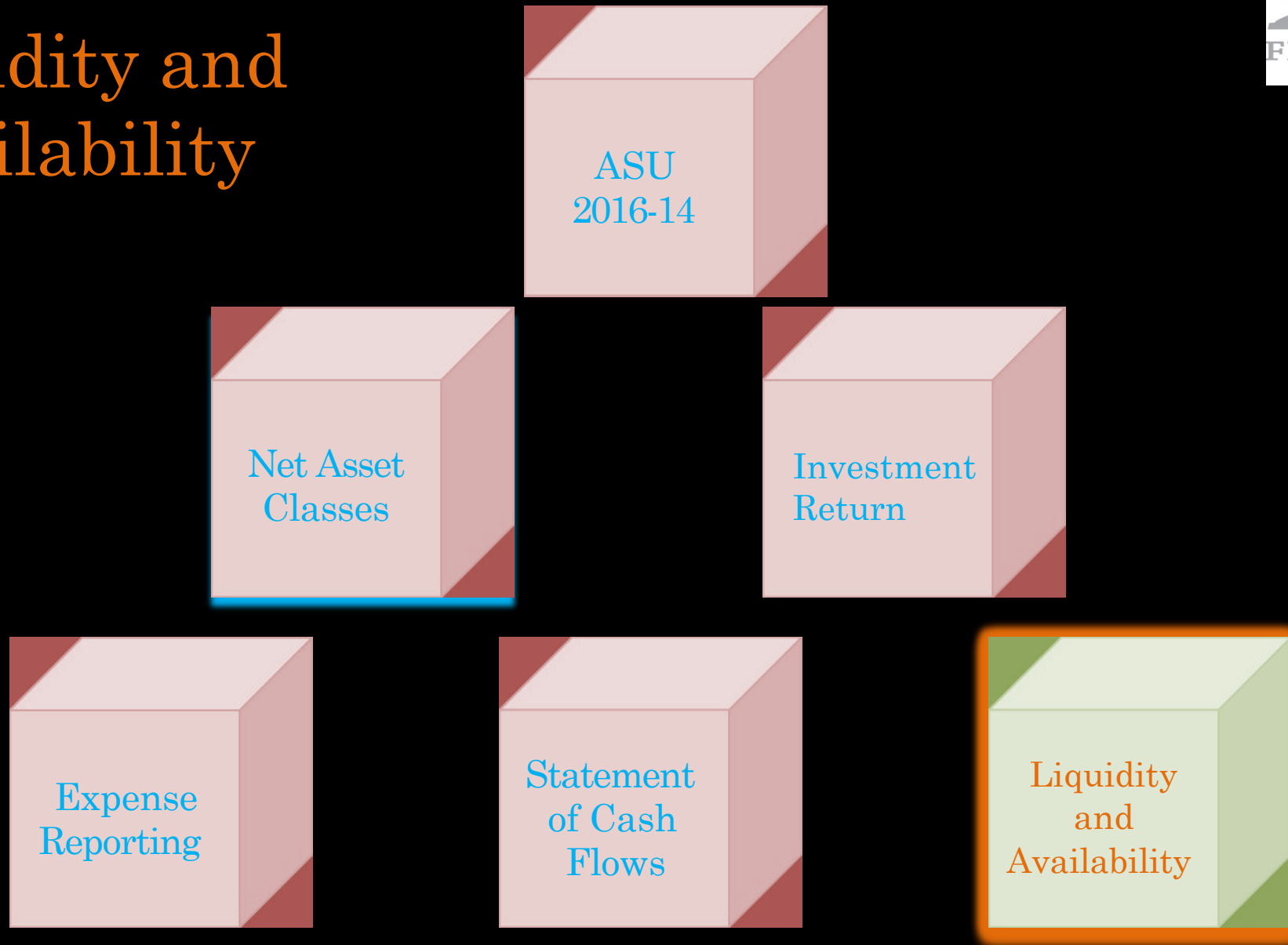
# Expense Reporting Management Considerations

- What is the best format for presenting the expense analysis?
- Are functional or natural expense classifications shown on the face of the statements?
- Do current allocation methodologies need to be revisited?
- Are functional classifications accurately captured in the financial system?

# Expense Reporting Board Discussions

- Explain the need for an analysis of expenses by:
  - Function
  - Nature
- Discuss how this might differ from what's included in the form 990
- Discuss anticipated costs of preparing disclosures

# Liquidity and Availability





# Liquidity and Availability of Resources

NFPs now required to provide both qualitative and quantitative information about the liquidity of the organization.

# Qualitative vs. Quantitative Information

## Qualitative Information

- How the NFP manages its liquid available resources and its liquidity risk.
- How the NFP will meet cash needs for general expenditures within one year of the date of the statement of financial position.

## Quantitative Information

- The availability of an NFP's current financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the date of the statement of financial position.
- Availability of a financial asset may be affected by:
  - Its nature
  - External limits (donors, laws, contracts)
  - Internal limits (board designated funds)

# Disclosures on Availability of Financial Assets

## ❑ Required General Disclosures

### ➤ Unusual Circumstances

Example: Special borrowing arrangements, requirements to hold cash in separate accounts

### ➤ Donor Imposed Restrictions

Example: Organization does not maintain enough cash/cash equivalents to comply with restrictions

### ➤ Information about Significant Limits

Example: Suppliers, creditors, certain loan covenants

## ❑ Required Disclosures on Restrictions

### ➤ Description of the kind of asset whose use is limited

### ➤ Information about the nature and amount of limitations

### ➤ Contractual limitations on use of particular assets

# Example: Qualitative Disclosure on Liquidity and Availability

Nonprofit Entity ABC Statement of Financial Position December 31, 20XX	
	<u>Year1</u>
ASSETS	
Cash	\$ 150,000
Contributions receivable	40,000
Prepaid expenses	10,000
Short-term investments	600,000
Total assets	<u>\$ 800,000</u>
LIABILITIES AND NET ASSETS	
Accounts payable and accrued expenses	\$ 160,000
Total liabilities	<u>160,000</u>
Net assets without donor restrictions	600,000
Net assets with donor restrictions	40,000
Total net assets	<u>640,000</u>
Total liabilities and net assets	<u>\$ 800,000</u>

NFP A has \$790,000 of financial assets available within 1 year of the balance sheet date to meet cash needs for general expenditure consisting of cash of \$150,000, contributions receivable of \$40,000 and short term investments of \$600,000. 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 implied time restrictions but are expected to be collected in 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 \$550,000. NFP A has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. NFP A also has committed lines of credit in the amount of \$40,000 which it could draw upon in the event of an unanticipated liquidity need.

# Example: Quantitative Disclosure on Liquidity and Availability

Financial assets, at year-end*	<u>\$ 235,000</u>
Less those unavailable for general expenditures within year, due to:	
Contractual or donor-imposed restrictions	
Restricted by donor with time or purpose restrictions	(12,000)
Subject to appropriation and satisfaction of donor restrictions	(145,000)
Investment held in annuity trust	(5,000)
Amounts held by bond trustees	(30,000)
Board designations	
Quasi-endowment fund, primarily for long-term investing**	(37,000)
Amounts set aside for liquidity reserve	(2,000)
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 4,000</u>

\*Total assets, less nonfinancial assets (PP&E, inventory, prepaids)

\*\*Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions

# Liquidity and Availability Management Considerations

## ❖ What message do you wish to convey?

- Do you have ample resources to fund activities over the next 12 months?
- Are there significant restrictions or internal designations limiting the use of resources?
- What additional sources of liquidity are available?
- Should this message be conveyed in text, table, or both?

## ❖ Identify current policies and procedures

- Are existing procedures formally documented?
- Will any revisions to current policies or new policies be required?
- Are any board designations properly documented?

# Liquidity and Availability Board Discussions

- Explain the disclosure requirements
- Discuss best presentation for achieving transparency
- Review board designations
- Recommend any policy changes or additions
- Discuss anticipated costs of preparing disclosures

# What's Next?

Certain issues have been deferred  
to Phase II



# Phase II

- Whether to require more intermediate measures of operations and performance indicators
- How to define performance measures and what items should be included in analysis
- How to realign certain line items within such operating measures within operating cash flows
- Whether an alternative disaggregation and classification approach may be more decision useful
- Whether business-oriented health care NFPs should provide disaggregated information by segment

# Summary

- Discuss with management how to implement the change
- Consider the time and costs associated with the changes
- Update or create new policies related to the changes
- Review and discuss the changes with the Board, including any Board designations

# Contact Us

For inquiries or to request a proposal for audit, accounting or tax services, please contact:

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