In Focus: Accounting Standards ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*

June 2017

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Objectives and Background

OBJECTIVES OF TODAY'S SESSION

After today's session, you should be familiar with:

- Background leading up to the new ASU
- Significant changes to current practice
- Qualitative and quantitative requirements
- Impact to stakeholders
- What organizations can do to prepare for the changes
- Effective date and transition guidance

BACKGROUND

- On August 18, 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*
- This new guidance will be the first major set of changes to not-for-profit financial statement reporting standards since the issuance of FASB 117 in 1993, which established the current guidance
- While the FASB believes that the existing standards are still sound, stakeholders felt the standards could be improved to provide better information to donors, grantors, creditors, and other users of financial statements.

BACKGROUND

- The FASB's Not for Profit Advisory Committee (NAC) was established in 2009.
- Its mission is to ensure that the NFP sector's concerns are communicated to the FASB.
- The NAC consists of 18 members in the NFP sector and includes preparers, auditors and users of financial statements
- In 2011, the FASB added the NFP Financial Reporting project to its agenda as a result of recommendations from the NAC

BACKGROUND

- In April 2015 , the FASB issued the Exposure Draft for public comment
- The FASB received approximately 260 comment letters from preparers, users, auditors, academics and others.
- The FASB also held public roundtables, workshops and other outreach meetings. Based on the feedback, the FASB decided to split the project into 2 phases.
  - Phase 1 – Were changes that had broad support, did not depend on other projects and were improvements that the FASB could make quickly. Phase 1 culminated in this ASU.
  - Phase 2 – The FASB deferred its more controversial proposals which included requiring the same defined measure of operations for all NFPs's to Phase 2. The FASB has not said when it will complete Phase 2.

REDELIBERATIONS PLAN

Phase I ASU 2016-14 issued August 2016	Phase II
Net Asset Classes: • Classification scheme • Disclosure of board designated net assets • Underwater endowments • Expirations of capital restrictions	**Operating Measures--all other elements of the proposal, including:** • Whether to require intermediate measure(s) • Whether and how to define such measure(s), and what items should or should not be included in the measure(s) • Alternative disaggregation approaches suggested by stakeholders
Expenses/Investment Return: • Expenses by nature; analysis of expenses by function and nature • Netting of investment expenses against investment return • Disclosure of netted investment expenses • Enhanced disclosures about cost allocations	**Statement of Cash Flows:** • Realignment of certain items
Operating Measures: • Modest improvements to disclosures for those that use an operating measure, especially about board appropriations, designations, and similar transfers	**Phase 2**: Need to decide whether to wait to deliberate at same time as the **Financial Performance Reporting** project for business entities
Liquidity/Availability: • Quantitative disclosures about availability • Qualitative disclosures about liquidity • Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet)	
Statement of Cash Flows: • Methods of presenting operating cash flows (direct/indirect)	

* Source: FASB Presentation, *IN FOCUS:* Accounting Standards Update on Not-for-Profit Financial Statements (ASU 2016-14) - Sept 2016

Significant Changes

WHAT ARE THE KEY PROVISIONS OF THE NEW STANDARD?

- Revises the net asset classification to two classes instead of the previous three.
  - With donor restrictions
  - Without donor restrictions
- Enhances disclosures for self-imposed limits on the use of resources without donor-imposed restrictions (designated net assets) and the composition of net assets with donor restrictions.
- Updates the accounting and disclosure requirements for underwater endowment funds.
- Requires net presentation of investment expenses against investment return and eliminates the requirement to disclose investment expenses

WHAT ARE THE KEY PROVISIONS OF THE NEW STANDARD?

- Requires the presentation of expenses by nature as well as function
- Requires qualitative disclosures on how a not-for-profit manages its available liquid resources.
- Requires quantitative disclosures that communicate the availability of financial assets to meet cash needs for general expenditures within one year of the balance sheet date.
- Allows for a choice between the direct and indirect method of reporting operating cash flows.

What does CohnReznick Think? We think it is important to begin educating your stakeholders (e.g., bankers, donors, board members, etc.) about these changes. We strongly encourage you to engage your board members and key management personnel in your implementation process.

NET ASSETS

Current GAAP	Unrestricted	Temp. Restricted	Perm. Restricted
Revised GAAP	Without Donor Restrictions*	With Donor Restrictions*	
+			
Disclosures	Amount, purpose, and type of board designations **	Nature and amount of donor restrictions	

* NFPs may choose to disaggregate further
** New disclosure requirement

* Source: FASB Presentation, *IN FOCUS:* Accounting Standards Update on Not-for-Profit Financial Statements (ASU 2016-14) - Sept 2016

WHY THE CHANGE IN NET ASSET CLASSIFICATION?

- To reduce complexity
- The distinction between permanent and temporary restrictions has been blurred due to changes in state laws and the widespread adoption of the Uniform Prudent Management of Institutional Funds Act of 2006 ("UPMIFA").
- **Important things to keep in mind:**
  - Donor stipulations will be the only factor in determining how net assets are classified.
  - Although net assets may have **no donor restrictions,** there may still be other restrictions that must be disclosed (e.g. board designated)

What does CohnReznick Think? Although there will be a reduction in the net asset classifications on your balance sheet, you should be careful to not lose track about restrictions in your general ledger.

EXAMPLE OF A STATEMENT OF FINANCIAL POSITION

Showing Revised Net Asset Classes

Not-for-Profit Entity A
Statements of Financial Position
June 30, 20X1~~[illegible]~~ and 20X0~~[illegible]~~
(in thousands)

	20X1	20X0
Assets:		
Cash and cash equivalents	$ 4,575	$ 4,350
Accounts and interest receivable	2,130	1,670
Inventories and prepaid expenses	610	1,000
Contributions receivable	3,025	2,700
Short-term investments	1,400	1,000
Assets restricted to investment in land, buildings, and equipment	5,210	4,560
Land, buildings, and equipment	61,700	63,590
Long-term investments	218,070	203,500
Total assets	$ 296,720 ~~[illegible]~~	$ 282,890 ~~[illegible]~~
Liabilities and net assets:		
Accounts payable	$ 2,570	$ 1,050
Refundable advance		650
Grants payable	875	1,300
Notes payable		1,140
Annuity trust obligations	1,685	1,700
Long-term debt	5,500	6,500
Total liabilities	10,630	12,340
Net assets:		
Without donor restrictions (Note D) ~~Unrestricted~~	92,600 ~~[illegible]~~	84,570 ~~[illegible]~~
With donor restrictions ~~Temporarily restricted~~ (Note B)	193,490 ~~[illegible]~~	185,970 ~~[illegible]~~
~~Permanently restricted (Note C)~~	~~[illegible]~~	~~[illegible]~~
Total net assets	286,090 ~~[illegible]~~	270,540 ~~[illegible]~~
Total liabilities and net assets	$ 296,720 ~~[illegible]~~	$ 282,890 ~~[illegible]~~

Note: See paragraph 958-205-55-21 for the notes to financial statements.

* Reproduced from FASB ASU 2016-14 (958-205-55-9)

ALTERNATIVE EXAMPLE OF PRESENTATION OF NET ASSET SECTION

of Statement of Financial Position

> > Example 1: Format of the Net Asset Section

958-210-55-3 As illustrated in paragraph 958-205-55-9, this Subtopic encourages the use of the terms **net assets with donor restrictions** and **net assets without donor restrictions**~~**unrestricted, temporarily restricted, and permanently restricted net assets**~~; however, other labels exist. For example, equity may be used for net assets, and other or not donor-restricted may be used with care to distinguish net assets with donor restrictions from net assets without donor restrictions~~unrestricted net assets from the temporarily and permanently restricted classes of net assets~~. For example, the net asset section might be arranged as follows.

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

* Reproduced from FASB ASU 2016-14 (958-210-55-3)

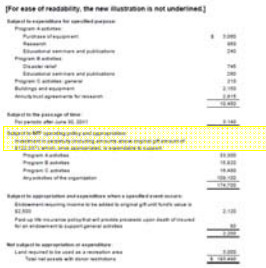
NET ASSET DISCLOSURES

- Must still disclose information about the nature and amounts of donor imposed restrictions.
- NFP's will be able to report separate line items within net assets with donor restrictions on the statement of financial position or in the notes to the financial statements, to distinguish between the types of donor-imposed restrictions.
- The new standard requires disclosure of the amounts and purposes for ALL board-designated net assets (for example, those designated for future expenditures, capital projects or other uses).

What does CohnReznick Think? The FASB has said that these are the minimum requirements. The FASB does not preclude not-for-profits from disclosing more information in an effort to tell their story.

SAMPLE FOOTNOTE: NET ASSETS WITH DONOR RESTRICTIONS

Example Footnote "B"


[For ease of readability, the new illustration is not underlined.]

* Reproduced from FASB ASU 2016-14 (958-205-55-21)

EXAMPLE FOOTNOTE FOR BOARD DESIGNATED NET ASSETS

Note DD

Not-for-Profit Entity A's governing board has designated, from net assets without donor restrictions of $92,600, net assets for the following purposes as of June 30, 20X1.

Quasi-endowment	$ 36,600
Liquidity reserve	$ 1,300
Total	$ 37,900

* Reproduced from FASB ASU 2016-14 (958-205-55-21)

"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 actions taken, concerning appropriation from such funds.

* Source: FASB Presentation, *IN FOCUS:* Accounting Standards Update on Not-for-Profit Financial Statements (ASU 2016-14) - Sept 2016

"UNDERWATER" ENDOWMENTS

- An "underwater endowment fund" is a 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 .
- Current guidance requires accumulated losses to be shown as a reduction of unrestricted net assets and to present the endowment fund at the amount required to be maintained by the donor or by law.
- Under the new standard, if a donor-restricted endowment fund is an **underwater endowment fund,** the accumulated losses will be included together with that fund in net assets **with donor restrictions**. (**958-205-45-13H)**

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"UNDERWATER" ENDOWMENTS DISCLOSURES

- For each period for which a statement of financial position is presented, an NFP shall disclose each of the following, in the aggregate, for all underwater endowment funds: (**958-205-50-2)**
  a. The fair value of the underwater endowment funds
  b. The original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions
  c. The amount of the deficiencies of the underwater endowment funds ((a) less (b)).

What does CohnReznick Think? As UPMIFA assumes that organizations will act to preserve principal (historic dollar value), we encourage you to keep track of the principal in your general ledger.

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EXPIRATION OF CAPITAL RESTRICTIONS

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

- If there is no explicit donor time restriction, then the NFP must use the **placed in service approach**. This approach requires that the full amount of the gift be reclassified to net assets without donor restriction when the asset is placed in service.
- **No more implied time restrictions. (958-360-45-1A)** Healthcare NFPs are already required to do so.

What does CohnReznick Think? Keep in mind, the donor intent ultimately determines the recordkeeping treatment. If there is an **explicit time restriction** from the donor, then the restriction would be released over the stated period of time.

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REPORTING OF INVESTMENT RETURN

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
  - May report net return in **multiple**, appropriately labeled lines (e.g., from different portfolios, in different net asset classes, or in operating versus non-operating)

What to disclose?

- Disclosure of investment expenses **no longer required**
  - If reported, carefully label and don't include in expense analysis
- No longer require disclosure of investment return **components**

* Source: FASB Presentation, *IN FOCUS:* Accounting Standards Update on Not-for-Profit Financial Statements (ASU 2016-14) - Sept 2016

REPORTING OF INVESTMENT RETURN

- Direct internal investment expenses involve the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return. These include, but are not limited to, both of the following:
  - Salaries, benefits, travel, and other costs associated with the officer and staff responsible for the development and execution of investment strategy
  - Allocable costs associated with internal investment management and supervising, selecting, and monitoring of external investment management firms. **(958-225-45-14A)**
- The current standard allows the option to net investment expense against revenue (both internal and external); however, organizations are required to disclose the netted expense.

What does CohnReznick Think? This will eliminate inconsistencies in practice. Please note that the netted investment expense should not be included in the statement of functional expenses. Therefore, it will alter functional expense ratios.

EXPENSE REPORTING

- Under the new standard, ALL NFP's will be required to present expenses by function AND nature. **(958-720-45-15).**
- This information must be shown in one location (either all in the notes or all on the face of the financial statements.
- Under current GAAP, all NFP's must present expenses by function and currently **only** voluntary health and welfare organizations are required to also present expenses by their nature (rent , salaries , etc.)

EXPENSE REPORTING (CONT'D.) DISCLOSURES

- NFPs will also be required to provide qualitative disclosures about the methods used to allocate costs among program and support functions **(958-720-50-1)**
- Will be required to assess which activities are direct conduct or direct supervision of a program or support function and, therefore, would require allocation of costs.
- Will be required to disclose the cost allocation method used to allocate costs of activities identifiable with one or more program, fundraising, or membership-development activities. Some examples CEO, CFO, Human Resources Dept. and Grant Accounting and Reporting (**958-720-55-171-175)**

What does CohnReznick Think? The additional disclosure requirement should be a good opportunity for Organizations to reevaluate how they functionally allocate expenses.

SAMPLE STATEMENT OF FUNCTIONAL EXPENSES

ABC ORGANIZATION

Statement of Functional Expenses
Year Ended XXXX

	Program services			Supporting services			
	Program A	Program B	Total Progam	Management and general	Fund-raising	Total Support Services	Total Expenses
Salaries and wages							
Payroll taxes and employee benefits							
Total salaries and related expenses							
Professional fees							
Travel							
Books, dues and subscriptions							
Advertising							
Occupancy							
Repairs and maintenance							
Stationery, supplies and printing							
Postage and shipping							
Telephone							
Insurance							
Interest							
Depreciation and amortization							
Other							
Total expenses							

EXAMPLE FOOTNOTE: QUALITATIVE DISCLOSURE ABOUT EXPENSE ALLOCATIONS

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.

Reproduced from FASB ASU 2016-14 (958-720-55-176)

LIQUIDITY AND AVAILABILITY OF RESOURCES

NFPs required to provide:

- Qualitative information on how the NFP manages its liquid available resources and its liquidity risk (in the notes)
- Quantitative information that communicates the availability of the NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)

LIQUIDITY AND AVAILABILITY OF RESOURCES

- The Board concluded that information about the availability of an NFP's financial assets and management of its liquid resources is useful to creditors, donors, grantors, and others that are interested in assessing an NFP's liquidity and financial flexibility.
- These disclosures may be the most difficult for NFP's to understand and implement,
- The Standard includes examples illustrating different ways that a NFP might show the liquidity availability disclosure

What does CohnReznick Think? We think it is important to start discussing this disclosure with your stakeholders as soon as possible. We also believe it is important to agree on a disclosure format and apply it consistently in the future.

SAMPLE LIQUIDITY FOOTNOTE

Note G

The following reflects Not-for-Profit Entity A's financial assets as of the balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date. Amounts not available include amounts set aside for long-term investing in the quasi-endowment that could be drawn upon if the governing board approves that action. However, amounts already appropriated from either the donor-restricted endowment or quasi-endowment for general expenditure within one year of the balance sheet date have not been subtracted as unavailable.

[For ease of readability, the new illustration is not underlined.]

Financial assets, at year-end	$ 234,410
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions	(174,700)
Investments held in annuity trust	(4,500)
Board designations:	
Quasi-endowment fund, primarily for long-term investing	(36,900)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	$ 5,070

Not-for-Profit 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, Not-for-Profit Entity A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of Not-for-Profit Entity A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, Not-for-Profit Entity A 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, which was $1,300 as of June 30, 20X1. There 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. In the event of an unanticipated liquidity need, Not-for-Profit Entity A also could draw upon $10,000 of available lines of credit (as further discussed in Note XX) or its quasi-endowment fund.

Reproduced from FASB ASU 2016-14 (958-205-55-21)

SAMPLE LIQUIDITY FOOTNOTE

Not-for-Profit Entity A
Statement of Financial Position
June 30, 20X1
(in thousands)

	20X1
Assets:	
Cash	$ 75,000
Contributions receivable	20,000
Prepaid expenses	5,000
Short-term investments	300,000
Total assets	$ 400,000
Liabilities:	
Accounts payable	$ 80,000
Total liabilities	80,000
Net assets:	
Without donor restrictions	300,000
With donor restrictions	20,000
Total net assets	320,000
Total liabilities and net assets	$ 400,000

958-210-55-7 NFP A has $395,000 of financial assets available within 1 year of the balance sheet date to meet cash needs for general expenditure 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 implied time restrictions but are expected to 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. NFP A has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, 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.

> > > Case B

958-210-55-8 NFP A presents a classified statement of financial position with additional qualitative information about availability of resources and liquidity in Note T.

CASH FLOW STATEMENT

- Continue to have a choice between the **Direct Method** or the **Indirect Method** of presenting operating cash flows
- The Indirect reconciliation will no be longer required when using the Direct Method
- The Exposure Draft had initially proposed requiring all NFP's to use the direct method. However, in the comment letters received, many questioned requiring this of NFPs, while allowing business entities to continue to have flexibility.

OPERATING MEASURE: IMPROVED DISCLOSURES

Reinforcing current GAAP requirement about the transparency of components of any operating measures presented:

- NFPs utilizing an operating measure that reflects governing board designations, appropriations, and similar actions (internal transfers) must report these types of internal transfers appropriately disaggregated and described by type (either on the face of the statement of activities or in the notes)

EFFECTIVE DATE, EARLY ADOPTION, AND TRANSITION

Effective Date: For fiscal years beginning after 12/15/2017 (e.g., CY 2018, FY 2018-19)
- And for interim periods within fiscal years beginning after December 15, 2018

Early Adoption: Permitted, but must apply the regular transition provisions.

Transition:
- For year of adoption: apply **all** provisions.
- For comparative years presented: apply all provisions, except can choose not to present:
  - Analysis of expenses by nature and function*, and/or
  - Disclosures around liquidity and availability of resources

**Unless already required to do so under current GAAP*

WHAT CAN YOU DO NOW TO PREPARE?

- Read the "Summary" at the beginning of the ASU and the "Basis for Conclusions" at the back of the ASU (about 30 pages in total).
- Change general ledger grouping codes to enable you to report two classes of net assets instead of three.
- Prepare a pro-forma financial statement.
- Identify external and direct internal investment expenses, including allocable costs, if applicable.

WHAT CAN YOU DO NOW TO PREPARE?

- Identify investment expenses (including both external and direct internal expenses, including allocable costs, if applicable).
- Discuss liquidity disclosures with your Board and management team.

Stay current by:
- Signing up for electronic alerts from the FASB
- Listening to webcasts from the FASB
- Reviewing sample financial statements on the AICPA website
- Reviewing financial statements of other large NFP organizations that early adopt.

THANK YOU

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