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Heads Up

NFP Makeover

FASB Issues Proposed ASU on Presentation of Not-for-Profit Entities' Financial Statements

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On April 22, 2015, the FASB issued a proposed ASU[1] that would significantly change the existing presentation requirements for financial statements of not-for-profit entities (NFPs). The proposal is intended to improve the current requirements for net asset classification as well as the information presented in the financial statements and notes to the financial statements regarding liquidity, financial performance, and cash flows for NFPs. Specifically, the proposed ASU addresses (1) the complexity and understandability of net asset classifications, (2) inconsistent reporting of intermediate measures of operations in the statement of activities, (3) lack of consistency in the type of information provided about expenses for a period, and (4) inconsistencies in the reporting of operating information in the statement of activities and operating cash flows within the statement of cash flows.

The proposal would affect NFPs and would amend ASC 958[2] as well as certain requirements in ASC 954.

This *Heads Up* summarizes key provisions of the proposed ASU. Comments on the proposal are due by August 20, 2015.

Editor's Note: Many of the provisions in the proposed ASU differ significantly from existing U.S. GAAP, including current guidance on accounting by for-profit entities. For example, the proposed ASU would change aspects of the cash flow statement whose underlying economics are generally the same for both NFPs and for-profit entities. NFPs should fully engage in the comment letter process to ensure that the FASB fully understands the implications of its proposed changes. Planning for these changes will be important since they could involve systems changes and changes to an entity's internal control over financial reporting. For-profit entities might also consider commenting on the proposed ASU since it could foreshadow future proposals.

[1] FASB Proposed Accounting Standards Update, *Presentation of Financial Statements of Not-for-Profit Entities*.

[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Main Provisions of the Proposed ASU

Net Assets

Under existing U.S. GAAP, three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) are presented in the statement of financial position. Under the proposed ASU, however, an NFP would present only two classes of net assets (*net assets with donor restrictions* and *net assets without donor restrictions*) in the statement of financial position at the end of the period. See Appendix A for an example that illustrates how an NFP would adjust the presentation of net assets in its statement of financial position to reflect these two classes instead of the three classes required under current guidance.

> **Editor's Note:** The FASB decided that the complexity of distinguishing between permanent and temporary restrictions is unwarranted and that better information would be obtained from disclosures about the nature, amounts, and effects of the various types of donor-imposed restrictions, including information about the purposes for which the resources can be used and the time frame for their use.

Statement of Activities

Under the proposed ASU, an NFP would present in the statement of activities the change in each of the two new classes of net assets in a manner similar to how it presents the change in each of the three net asset classes specified under current guidance. An NFP would also be required to present in the statement of activities two additional subtotals for activities associated with changes in *net assets without donor restrictions*:

a. The first subtotal includes operating revenues, support, expenses, gains, and losses that are without donor-imposed restrictions and is before internal transfers.

b. The second subtotal includes the effects of internal transfers resulting from governing board designations, appropriations, and similar actions that place (or remove) self-imposed limits on the use of resources that make them unavailable (or available) for current-period operating activities.

> **Editor's Note:** The FASB believes that requiring more standardized intermediate measures of operations (i.e., the proposed subtotals that show the operating excess or deficit both before and after transfers) would increase comparability of information across the NFP sector, especially within industries.
>
> The proposed ASU indicates that these intermediate measures of operations are designed to reflect a distinction between operating activities for the period and other activities "on the basis of whether the resource inflows and outflows are from or directed at carrying out an NFP's purpose for existence and available for current-period operating activities."
>
> As detailed in the "Alternative Views" section of the proposed ASU, FASB Chairman Russell Golden and FASB Vice-Chairman James Kroeker disagree with requiring the new measures of operating performance. They believe that "it is inappropriate to include in operating results the impact of internal and arbitrary events, including discretionary items or other similar items that are not the result of transactions with a third party, changes in the measurement of assets or liabilities, or other outside events. Furthermore, [they believe that] at the extreme it would permit entities to effectively emphasize a GAAP measure of operating performance that they select and choose to report."

See Appendix B for a sample presentation of an NFP's statement of activities showing the two new subtotals that would be required under the proposed ASU.

There would no longer be a requirement to present the intermediate measure of operations on the same page as the change in net assets without donor restrictions (though an NFP can still choose to do so). In addition, the proposed ASU would eliminate the guidance in ASC 954-225-45-4 requiring business-oriented health care NFPs to present a *performance indicator*.

Further, the proposed ASU would remove the guidance requiring voluntary health and welfare organizations to provide a statement of functional expenses and instead would require all NFPs to present information about the nature and function of such expenses (1) in the statement of activities, (2) as a separate statement, or (3) in the notes to the financial statements. In addition, investment income would be reported net of external and direct internal investment expense.

Statement of Cash Flows

Under the proposal, an NFP would be required to report in the statement of cash flows the net amount for operating cash flows by using the direct method of accounting.

Editor's Note: This proposed requirement represents a significant change from current practice and would create a difference between the cash flow presentation of NFPs and that of for-profit entities. In addition, NFPs may have difficulty tracking the information necessary for a direct-method cash flow statement to be prepared and audited.

The proposed ASU would further change current practice for NFPs and differentiate NFPs' cash flow presentation from that of for-profit entities by requiring NFPs to present:

- Purchases of long-lived assets, contributions restricted to acquire long-lived assets, and sales of long-lived assets as operating cash flows rather than as investing cash flows.
- Payments of interest on borrowings (including cash management activities) as financing cash flows rather than as operating cash flows.
- Receipts of interest and dividends on loans and investments (other than those made for programmatic purposes) as investing cash flows rather than as operating cash flows.

Disclosures

The proposed ASU would enhance the disclosure requirements for NFPs. Under its provisions, an NFP would be required to disclose the following:

- "Governing board designations, appropriations, and similar transfers that result in the addition or removal of self-imposed limits on the use of resources without donor imposed restrictions."
- "Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources."
- "Management of liquidity and quantitative information as of the reporting date about financial assets available to meet near-term demands for cash, including demands resulting from near-term financial liabilities."
- "Expenses, including amounts for operating expenses by both their nature and function."
- "Method(s) used to allocate costs among program and support functions."
- "Underwater endowment funds, which are donor-restricted endowment funds for which the fair value of the fund is less than either the original gift amount or the amount required to be maintained by the donor or law."

Effective Date and Transition

The proposed ASU would be applied on a retrospective basis, but the application to interim financial statements would not be required in the initial year of adoption. However, if the interim information is included in the annual financial statements in the year of adoption, the interim periods would need to be retrospectively adjusted. Upon adoption, an entity would disclose the nature of any reclassifications or restatements and their impact on net assets for the years presented in the financial statements.

The Board will determine the effective date after reviewing feedback on the proposed ASU. It tentatively plans to hold two roundtable meetings to solicit stakeholders' views. The first meeting is planned for September 21, 2015, at the FASB's office in Norwalk, Connecticut; the second is expected to be held on the West Coast on October 6, 2015.

Editor's Note: This proposal represents the most significant change to NFP accounting guidance since 1993, when the FASB issued Statements 116[3] and 117[4] (both now codified in ASC 958).

[3] FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*.

[4] FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*.

Appendix A — Statement of Financial Position Showing Revised Net Asset Classes

The example below, which is reproduced from the proposed ASU, illustrates how an NFP would adjust the presentation of net assets in its statement of financial position to reflect two classes rather than the three classes required under current guidance.

Not-for-Profit Entity A
Statements of Financial Position
June 30, 20X1~~19X1~~ and 20X0~~19X0~~
(in thousands)

	20X1~~19X1~~	20X0~~19X0~~
Assets:		
Cash and cash equivalents	$ 4,575 ~~75~~	$ 4,960 ~~460~~
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 ~~292,220~~**	**$ 282,980 ~~278,480~~**
Liabilities and net assets:		
Accounts payable	$ 2,570	$ 1,050
Refundable advance		650
Grants payable	875	1,300
Notes payable		1,140
Annuity obligations	1,685	1,700
Long-term debt	5,500	6,500
Total liabilities	**10,630**	**12,340**
Net assets:		
Without donor restrictions (Note DDD)~~Unrestricted~~	92,677 ~~115,228~~	73,619 ~~103,670~~
With donor restrictions~~Temporarily restricted~~ (Note B)	193,413 ~~24,342~~	197,021 ~~25,470~~
~~Permanently restricted (Note C)~~	~~142,020~~	~~137,000~~
Total net assets	286,090 ~~281,590~~	270,640 ~~266,140~~
Total liabilities and net assets	**$ 296,720 ~~292,220~~**	**$ 282,980 ~~278,480~~**

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

Appendix B — Statement of Activities Showing Two New Subtotals

The example below, which is reproduced from the proposed ASU, illustrates how an NFP's statement of activities would be presented to reflect two additional subtotals for activities associated with changes in net assets without donor restrictions.

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues and gains:			
Contributions	$ 8,640	$ 8,390	$ 17,030
Fees	5,200		5,200
Other	150		150
Gains	200		200
Total revenues and gains without donor restrictions	14,190		22,580
Net assets released from restrictions (Note D):			
Satisfaction of program restrictions	21,990	(21,990)	—
Satisfaction of equipment acquisition restrictions	1,500	(1,500)	—
Expiration of time restrictions	1,250	(1,250)	—
Appropriation from donor endowment	7,500	(7,500)	—
Total net assets released from restrictions	32,240		
Total revenues, gains, and other support without donor restrictions	46,430		
Expenses and losses:			
Program A	13,100		13,100
Program B	8,540		8,540
Program C	5,760		5,760
Management and general	2,038		2,038
Fundraising	2,150		2,150
Total expenses	31,588		31,588
Fire loss	80		80
Total expenses and losses	31,668		31,668
Operating excess, before transfers	14,762		
Board designations, appropriations, and similar transfers to/(from) operations:			
Investment returns appropriated from quasi-endowment	2,000		2,000
Transfer of gifted equipment	(140)		(140)
Transfer of equipment acquired with donor-restricted funds and placed in service	(1,500)		(1,500)
Operating excess, after transfers	15,122		
Nonoperating changes:			
Investment return, net (Note E)	4,678	20,272	24,950
Interest expense	(382)		(382)
Actuarial loss on annuity obligations		(30)	(30)
Board designations, appropriations, and similar transfers to/(from) nonoperations:			
Investment returns appropriated for current operations from quasi-endowment	(2,000)		(2,000)
Transfer of gifted equipment	140		140
Transfer of equipment acquired with donor-restricted funds and placed in service	1,500		1,500
Increase (decrease) in net assets	19,058	(3,608)	15,450
Net assets at beginning of year	73,619	197,021	270,640
Net assets at end of year	$ 92,677	$ 193,413	$ 286,090

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

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