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IS YOUR ORGANIZATION READY FOR THE NEW NFP REPORTING REQUIREMENTS?

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September 11, 2018



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NET ASSET CLASSIFICATIONS



*How will you
report your net
asset balances
and activity
based on the new
classification
classes?*

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OVERVIEW OF ASU 2016-14

- **Presentation of Financial Statements of NFP Entities**
- **Released in August 2016 and effective for years beginning after 12/15/17**
- **Examples: December 31, 2018 and June 30, 2019**
- **Early adoption is permitted**
- **Requires retrospective implementation for dual-year reports**

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OVERVIEW OF ASU 2016-14

- **Improvements in financial reporting needed in these areas:**
 - *Three-class net asset system considered to be complex*
 - *Inconsistent reporting of expenses by NFPs*
 - *Better information needed regarding liquidity and financial performance*
 - *Investment returns to be reported net of direct investment expenses*

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CHANGES TO NET ASSET REPORTING

- **Elimination of Temporary vs. Permanent Restrictions**
 - *Must present totals for net assets with donor restrictions and net assets without donor restrictions*
 - *Statement of activities would also report the change in these two net asset classes*

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NET ASSET DISCLOSURES

- **Nature and amount of different donor restrictions**
 - *Assets that cannot be sold or must provide a permanent source of income (permanent restrictions)*
 - *Provided for the support of specific activities*
 - *Held for a specified term or used in a specified period*
 - *Restricted for the acquisition of long-lived assets*

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OPTIONAL NET ASSET REPORTING

- **Organizations may wish to present more detail regarding the nature of donor restrictions**
 - *Fund (building, endowment, scholarship etc.)*
 - *Details of programmatic purposes*
 - *Specific fiscal years for longer-term time restrictions*
- **Nature of amounts released from restriction**

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EXAMPLE – NET ASSET DISCLOSURE

Subject to expenditure for specified purpose:	
Program A activities	\$ X,XXX,XXX
Program B activities	X,XXX,XXX
Buildings and equipment	<u>X,XXX,XXX</u>
Total	<u>X,XXX,XXX</u>
Subject to passage of time:	
For periods after December 31, 2019	<u>X,XXX,XXX</u>
Subject to spending policy and appropriation:	
Investment into perpetuity	<u>X,XXX,XXX</u>
TOTAL	\$ X,XXX,XXX

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EXAMPLE – RELEASE FROM RESTRICTION DISCLOSURE

Purpose restrictions accomplished:	
Program A expenses	\$ X,XXX,XXX
Program B expenses	X,XXX,XXX
Program A equipment acquired and placed in service	<u>X,XXX,XXX</u>
Total	<u>X,XXX,XXX</u>
Time restrictions expired:	
Passage of specified time	X,XXX,XXX
Death of annuity beneficiary	<u>X,XXX,XXX</u>
Subject to spending policy and appropriation:	
	<u>X,XXX,XXX</u>
Total restrictions released	<u>\$ X,XXX,XXX</u>

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ENDOWMENT FUNDS

- **Endowments may be donor-restricted or board-designated**
 - *Endowments with donor-imposed restrictions MUST be in net assets with restrictions*
 - *Board-designated endowments are included in net assets without restriction*

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BOARD DESIGNATED NET ASSETS

- **Disclosure was option under prior standards**
- **New standards require disclosure of all self-imposed limits on the use of resources without donor-imposed restrictions**
 - *Options for presentation*
 - *MUST be included in “without donor restrictions” category*

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LONG-LIVED ASSETS

- **Current guidance allows for 2 options:**
 - *In-service*
 - *Useful life*
- **New guidance eliminates the “useful life” option**

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STATEMENT OF ACTIVITY CONSIDERATIONS

- **Multiple presentation formats for the statement of activities**
 - *Consider which most clearly presents the activities and performance of your organization*
 - *Importance of restricted activities?*
 - *Comparative financial statements*
 - *Revenues and expenses need to be presented at gross amounts, except for investment activity and gains/losses*

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STATEMENT OF ACTIVITY CONSIDERATIONS

- **Revenues and expenses can be grouped in different ways**
 - *Restricted and unrestricted (required)*
 - *Operating and nonoperating*
 - *Earned and unearned*
 - *Recurring and nonrecurring*
 - *Other*

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STATEMENT OF ACTIVITY CONSIDERATIONS

- **Other disclosures**
 - *Total fundraising expenses*
 - *Total program expenses and information regarding differences between the statement of activities and the notes*
 - *Relationship between functional and natural classifications for all expenses*
 - *Description of the methods used to allocate costs among program and support functions*

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OTHER DISCLOSURE CONSIDERATIONS

- **Investment income need no longer be segregated between dividends/interest and gains/losses**
- **Investment rollforward (optional)**
- **Ratio of fundraising expenses to amounts raised – if presented, the method of determining must be disclosed**
- **Summarized comparative information – must be adequately labeled as summarized information, and is essentially a single-year presentation**

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IMPLEMENTATION CONSIDERATIONS

- **Review current restrictions (donor and board)**
- **Revisit your board-designated/internal endowment spending policy**
- **Identify changes needed in existing system**
- **Evaluate possible presentation options and disclosures for preferred method**
- **Be prepared to discuss these items with board and users of statements**

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REPORTING ON LIQUIDITY



Have you considered the new required financial statement disclosures regarding liquidity?

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LIQUIDITY – FASB OBJECTIVES

- **Improve portrayal of liquidity through improved net asset classifications**
- **Provide for commentary and analysis about the entity's financial health, operations and liquidity**

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WHAT IS LIQUIDITY?

- **An asset's or liability's nearness to cash**
- **Liquidity can be impacted by:**
 - *The nature of the asset or liability*
 - *Donor-imposed restrictions*
 - *Contractual requirements*
 - *Internal limits imposed by the governing body*

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CHALLENGES WITH CURRENT REPORTING

- **Desire to develop a framework for providing commentary on an entity's financial health, operations, and liquidity**
- **Understanding an entity's exposure to liquidity risks and how these risks are managed is important information to financial statement users**
- **Existence of donor-imposed restrictions or other limitations makes it difficult to assess the impact of those restrictions on liquidity**

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PRELIMINARY RECOMMENDATIONS

- **FASB initially sought to have entities present all of the following information:**
 - *Total amount of financial assets*
 - *Amount of financial assets not available to meet cash needs in the near term*
 - *Total of financial liabilities that require cash needs in the near term*
 - *The way the entity manages liquidity, including the time horizon it uses*

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PRESENTATION OF LIQUIDITY INFORMATION

- **Quantitative information about the availability of an NFPs financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the statement of financial position date**
 - *Simpler approach than initial recommendation*
 - *Objective is to make more transparent the effects of restrictions and other limitations on financial assets (vs. a true liquidity measurement)*

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PRESENTATION OF LIQUIDITY INFORMATION

- **Quantitative information may be presented directly on the statement of financial position or in the notes**
- **May include qualitative (narrative) information in the notes, as necessary**
- **Difficulty (and opportunity) may be in making a fairly vague disclosure meaningful and clear to financial statement users**

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LIQUIDITY POLICY

- **Qualitative information that is useful in assessing an entity's liquidity and that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the statement of financial position date**

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CONTINUATION OF RELATED DISCLOSURES

- **Unusual circumstances that limit liquidity and known significant liquidity problems**
- **The fact that an NFP has not maintained appropriate amounts of cash to comply with donor restrictions**
- **Information about significant limits resulting from contractual agreements, including the existence of loan covenants**

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EXAMPLES OF LIQUIDITY DISCLOSURES

- **Detail of financial assets recommended based on illustrations provided by FASB, but not specifically required (see Examples 1 and 2)**
- **Both examples combine the quantitative and qualitative information into one disclosure**
- **Disclosure should seek to address any ambiguity in your financial statements regarding liquidity**

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EXAMPLES OF LIQUIDITY DISCLOSURES

- **Receivables – current/noncurrent; trade/other; purpose restrictions**
- **Investments – marketability (alternative investments); held as collateral; held in an endowment; purpose restrictions**
- **Prepaid expenses – not financial assets, but may impact cash flow if significant**

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LIQUIDITY – IMPLEMENTATION CHECKLIST

- **Is there a liquidity policy?**
- **Has the nature of any restrictions or other limitations impacting liquidity been identified and considered?**
- **Are accounting processes in place to gather and present the required quantitative information?**

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LIQUIDITY – IMPLEMENTATION CHECKLIST

- **Has the accounting system been designed to generate this information directly and automatically?**
- **Is a review and analysis of liquidity a part of the monthly financial reporting process?**
- **Have board members been educated on the meaning of your liquidity information?**

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ENDOWMENT DISCLOSURES

- **Largely unchanged:**
 - *Net asset classification and composition*
 - *Changes in net asset composition*
 - *Spending policy*
 - *Investment policy*
- **Added disclosures regarding underwater endowments**

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ENDOWMENT DISCLOSURES

- **Underwater endowments – donor-restricted endowment funds for which the fair value is less than the original gift or the amount required to be maintained by the donor or by law**
- **Such amounts used to be reclassified to unrestricted net assets**
 - *Viewed as being inconsistent with UPMIFA appropriation rules*

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ENDOWMENT DISCLOSURES

- **Underwater balances remain in the respective restricted category as the overall endowment fund**
- **Must disclose:**
 - *Total fair value of any underwater funds*
 - *The amount that must be maintained (original gift or other amount required by donor or law)*
 - *The deficiency (the difference in the above)*

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EXPENSE PRESENTATION REQUIREMENTS



Are you prepared to present a statement of functional expenses and the methods of allocation and classification?

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REPORTING OF EXPENSES

- **Guidance requires reporting of expenses by natural and functional classification in one location**
- **Disclosures will require a description of the method(s) to allocated costs between programs and supporting functions (management/fundraising)**
- **Expected to enhance consistency in reporting among not-for-profit entities**

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REPORTING OF EXPENSES

- **Previously, only voluntary health and welfare organizations were required to provide a statement of functional expenses**
- **Revised guidance applies to all not-for-profit organizations**
- **Presentation of expenses required to be in one location, but does not require a separate statement**
- **Statement of activities, statement of functional expenses or a footnote disclosure**

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NATURAL EXPENSE CLASSIFICATION

- **Expenses grouped based on the kinds of economic benefits incurred**
 - *Salaries, rent, supplies, professional services, depreciation, grants*
 - *Expenses included in cost of goods sold on the statement of activities should be segregated into natural expenses on the statement of functional expenses*
 - *External and direct expenses netted against investment returns should not be included on the statement of functional expenses*

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FUNCTIONAL EXPENSE CLASSIFICATION

- **Expenses grouped according to the purpose for which costs are incurred**
 - *Program expenses*
 - *Support services separated (Management/General and Fundraising)*
 - *Methods for allocating costs among programs and supporting services will be disclosed in the footnotes to the financial statements*

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CONSIDERATIONS

- **If currently using functional expense classifications, evaluate those classifications in order to best present the activity of the entity**
- **Balance between too many and too few**
- **Are the entity's expenses being coded correctly?**
- **Presentation of programs**

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REPORTING

- **Guidance provides options for where to present the analysis of expenses**
 - *Statement of activities – an option for simple organizations or those with a singular program*
 - *Statement of functional expenses – probably best for organizations with multiple programs*
 - *Footnote disclosure – table within*

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OTHER CONSIDERATIONS

- Differences between the statement of functional expenses and the statement of activities, such as for costs included in CGS but segregated in the statement of functional expenses must be disclosed
- Do not confuse indirect costs for grant purposes with allocations of expenses for financial reporting
- Guidance provides clarity regarding the classification of expenses according to functions (program, management, fundraising, membership development)

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AICPA EXAMPLE – *Statement of Activities*

Expenses:	
Grant activities -	
Grants	12,125
Salaries, benefits and taxes	1,808
Occupancy costs	970
Depreciation	845
Supplies	1,255
Other	56
	17,059
Management and general -	
Salaries, benefits and taxes	452
Occupancy costs	243
Depreciation	211
Supplies	314
Other	14
	1,234
Total expenses	18,293

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AICPA EXAMPLE – Statement of Functional Expenses

	20XX			
	Animal Services	Management and General	Fundraising	Total
Grants	\$ 1,617,000	\$ 105,000	\$ -	\$ 1,722,000
Salaries and benefits	1,285,000	16,000	531,000	1,832,000
Education and awareness	706,000	54,000	245,000	1,005,000
Occupancy	203,000	30,000	72,000	305,000
Professional services	120,000	48,000	45,000	213,000
Printing	137,000	1,000	74,000	212,000
Information technologies	15,000	4,000	35,000	54,000
Travel	79,000	1,000	11,000	91,000
Depreciation	44,000	6,000	13,000	63,000
Other	80,000	18,000	113,000	211,000
	<u>\$ 4,286,000</u>	<u>\$ 283,000</u>	<u>\$ 1,139,000</u>	<u>\$ 5,708,000</u>

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FINANCIAL STATEMENT DISCLOSURES

- **Required to disclose methodologies related to allocation of costs among program and support functions**
 - *Disclose expenses that are allocated such as salaries/benefits, occupancy, depreciation, travel*
 - *Disclose methods such as hours worked, FTEs, square footage, units of service*
 - *Additional information that may provide clarity to the reader*

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AICPA EXAMPLE – Disclosure

- **Functional expenses** – The costs of providing program and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among animal services and supporting services benefited. Such allocations are determined by management on an equitable basis.




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AICPA EXAMPLE – Disclosure

- **The expenses that are allocated include the following:**

Expense	Method of Allocation
Grants	Time and effort
Salaries and benefits	Time and effort
Education and awareness	Time and effort
Occupancy	Square Footage
Professional services	Full Time Equivalent
Printing	Full Time Equivalent
Information technologies	Full Time Equivalent
Travel	Time and effort
Depreciation	Square Footage
Other	Time and effort



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APPLICATION

- **Retrospective application**
 - *If presenting comparative statements, the not-for-profit organization is not required to analyze expenses by natural and functional expense category for periods prior to adoption*
 - *A not-for-profit organization can choose to present a previous period consistent with the newly adopted presentation*

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THANK YOU FOR ATTENDING!

Next presentation: January 10, 2019

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