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Changes in Financial Reporting for Not-for Profits

By Harold Mohn, Managing Partner

Not-for-profit (NFP) accounting and reporting has historically been challenging for many accountants and users of NFP financial statements. NFP organizations report differently than their for-profit counterparts, requiring specific industry knowledge to ensure meaningful financial information.

Many accountants and users find that the NFP financial reporting framework is difficult to interpret. This becomes apparent in the boardroom and at management meetings where financial statement literacy may not always be a core skillset for all members. To address these concerns among users, on August 18, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, Not for Profit Entities (Topic 958): *Presentation of Financial Statements of Not-For-Profit Entities.*

The current guidance for NFP accounting and reporting dates back to 1993 when the FASB issued SFAS 116, *Accounting for Contributions Received and Contributions Made* and SFAS 117, *Financial Statements of Not-for-Profit Organizations*, which at the time represented significant change for NFPs. The intent of these standards was to enhance the relevance, usefulness and comparability of NFP financial statements.

Since NFP financial statements are primarily used by donors, members, creditors and others who provide resources to NFP entities, the goal of the standards was to allow these users to make better assessments concerning results of operations, management stewardship and how well an organization can continue to provide services. SFAS 117 introduced the concept of permanently, temporarily and unrestricted net assets in an NFP's financial statement rather than the traditional classification by funding source (known as fund accounting).

The new standard is meant to simplify and clarify accounting for NFP entities, as well as increase transparency of the financial statements for NFP entities. ASU 2016-14 focuses on a few primary areas, including net asset classification and liquidity disclosures. The standard will affect substantially all NFPs, as well as creditors, donors, grantors and others that use their financial statements.

Net Asset Classification

Under the SFAS 117, NFP entities were required to report three classes of net assets on their statement of financial position based upon the type of donor restriction placed upon net assets, be it permanent, temporary or unrestricted. These classifications proved to be confusing to users of NFP financial statements and difficult

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to apply in practice, especially in light of significant changes to endowment laws in recent years.

In an effort to simplify, under the new guidance, these three classifications will be replaced with two: 1) net assets with donor restrictions and 2) net assets without donor restrictions. Further, in response to changes in certain endowment laws which allow for prudent spending of underwater funds, i.e. permanently restricted gifts for which the value has decreased below the amount of the original gift, the underwater amount will be now classified as restricted and included with net assets with donor restrictions, and additional disclosures will be required.

Under the current rules, underwater funds are classified as unrestricted. The goal of these changes is to help users make a distinction between those net assets available for operations and those not.

Statement of Cash Flows

To incentivize NFPs to utilize the direct method, the standard eliminates the need to provide a reconciliation of the direct method of cash flows to the indirect method statement of cash flows when the direct method is presented.

“...the FASB’s goal is to improve the financial reporting of NFP entities to ensure that users of their statements received the most accurate picture of how the NFP is doing fiscally.”

Liquidity and Available Resources

The new ASU focuses on information about an organization’s available resources to enable users to understand liquidity risk. An NFP will be required to disclose qualitative information about how it evaluates its liquidity position and how it plans to utilize its available liquid resources to meet cash needs for general expenditures within a year of the date of the statement of financial position. Further, the ASU requires quantitative disclosures of its available liquid resources that are available to meet cash needs for general expenditures within one year of the date of the statement of financial position.

Expenses

The new ASU requires reporting information about operating expenses by both natural and functional classifications. These may be reported in one of three places: 1) as a separate statement, 2) on the face of the statement of activities or 3) as a note in the statement of activities. Qualitative information discussing the methods used to allocate expenses among program and support functions is also required. Finally, NFP entities will be required to share any returns on investments net of direct *internal* and related external expenses.

Effective Date

ASU 2016-14 is effective for financial statements for fiscal years beginning after December 15, 2017, with early adoption permitted. NFPs presenting comparative statements must apply the requirements of this ASU retrospectively, although omission of certain amendments is permitted for periods prior to adoption.

Although these changes will require significant effort, the FASB’s goal is to improve the financial reporting of NFP entities to ensure that users of their statements received the most accurate picture of how the NFP is doing fiscally. These new requirements are intended to benefit not only the NFP entity but the users, including donors, creditors and others that engage in business activities with NFP entities.

The goal of these changes is to help users make a distinction between those net assets that are available for the institutions operations and those that are not.