

NONPROFIT A&A ALERT

FASB Exposure Draft – Financial Statements of Not-for-Profit Entities

April 2015

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Not-for-Profit Entities Exposure Draft Has Sweeping Effects



In its first major rewrite since 1993, FASB is proposing to “refresh” the standards governing how nonprofit organizations report their financial information.

On April 22nd, FASB issued Proposed Accounting Standards Update (ASU) relating to Not-for-Profit Entities and Health Care Entities, *Presentation of Financial Statements of Not-for-Profit Entities*. Comments on the proposed ASU will be accepted by FASB through August 20, 2015.

FASB did not propose either an effective date or an implementation schedule for the new standard—instead, it will evaluate respondents’ comments to help it determine an appropriate date (or dates) during its redeliberation following the comment period.

The intent of the ASU is to improve net asset classification requirements and information provided in financial statements and disclosures about **liquidity, financial performance, and cash flows**.

Following are some of the key elements contained in the proposed ASU.

1. Proposed Changes to Net Asset Classifications

The number of net asset classes will be reduced from the current **three** to **two**.

Current GAAP	Unrestricted	Temporarily Restricted	Permanently Restricted
Proposed GAAP	Without Donor Restrictions	With Donor Restrictions	
Required Disclosures	Amount, Purpose, and Type of Board Designations*	Nature and Amount of Donor Restrictions	

*Denotes New Disclosure Requirement



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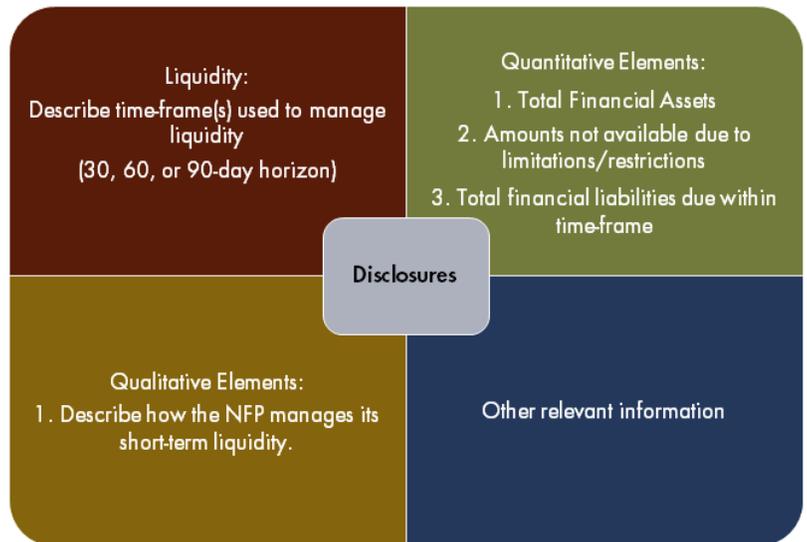
2. Proposed Changes to the Statement of Financial Position

- a. A classified Statement of Financial Position **will not** be required, as was earlier contemplated.
- b. Assets limited as to use will be distinguished on the face of the Statement of Financial Position, with disclosures of the types of limitations in the notes.
- c. Underwater endowments will be classified as “With donor restrictions” and require disclosures, in the aggregate, of fair value, original gift value, and the NFP’s spending policy with regard to underwater endowments.
- d. Notes are to include information on external restrictions:
 - i. Donor-imposed time or purpose restrictions.
 - ii. Designations by the Board of Directors or its designee.
 - iii. Contractual or other legal restrictions.

Liquidity disclosures are to include time horizon, qualitative, and quantitative considerations:



The proposed ASU provides additional information on how NFPs are to disclose how they manage liquidity.



3. Proposed Changes to the Statement of Activities

All entities will be required to provide an **overall operating measure** based on two dimensions—Mission and Availability of Resources. This measure replaces the performance indicator in health care entities.

Mission
(Business and Charitable Activity)

This is based on whether resources have been received from, or are directed at, carrying out an NFP’s purpose for existence.

Note: Investing and financing activities generally would be excluded from the Overall Operating Measure, as would all equity transactions.

Availability of Resources
(Current period – Future periods)

This is based on whether resources are available for current period activities, reflecting the limits imposed by:

1. External donors.
2. Internal actions of the NFP’s governing board, i.e., board designations.



The Operating Measure is key in FASB's proposed approach to improving comparability among the financial statements of nonprofit entities.

Excluded from the operating measure are the following:

- a. Any item of income or expense that is not mission-related.
- b. Investment return.
- c. Pension activity.
- d. Equity transactions with affiliates.
- e. Designations made/removed by Board, or its designee (these are reported as transfers in and out on separate lines after the operating subtotal and before the Overall Operating Measure).

The operating measure will include a **subtotal** before transfers to and from operating activities.

The Operating Measure

Revenues and support in excess of expenses before transfers ⁽¹⁾	X,XXX,XXX
Transfers to operating activities ⁽²⁾	XXX,XXX
Transfers from operating activities ⁽²⁾	<u>(XXX,XXX)</u>
Revenues and support in excess of expenses after transfers ⁽³⁾	<u>X,XXX,XXX</u>

⁽¹⁾Operating subtotal before transfers includes all legally available amounts generated by/used in operations of the current period, including the effects of donor restrictions and their expiration/satisfaction.

⁽²⁾Transfers are internal decisions to designate otherwise available amounts as unavailable, or vice versa. Transfers are presented in a discrete section after the operating subtotal and before the Overall Operating Measure.

⁽³⁾This is the **Overall Operating Measure**.

Treatment of **capital-like transactions** in the Statement of Activities is summarized as follows:

Transaction	Initial Period	When Placed in Service*
Receive a gift of a long-lived asset without donor restrictions.	Report all unrestricted gifts within operating.	Report a transfer out of operating and into nonoperating for the entire amount.
Receive a gift of cash for acquisition or construction of a long-lived asset.	Report as revenue that increases net assets with donor restrictions within operating.	Report release of donor restriction within operating <u>and</u> report a transfer out of operating and into nonoperating for the entire amount.

*NFPs are required to use the "placed in service" method and are no longer permitted to release donor restrictions as construction expenditures are made.



The following items **should be reported separately** from revenues, expenses, gains, and losses and presented within the operating activity section of the Statement of Activities and **before** the section of governing board transfers:

- a. The immediate write-off of goodwill upon an acquisition of an entity (required of NFPs] predominantly supported by contributions and investment income), unless the acquired entity is for a purpose or purposes that are not directed at carrying out the purpose for the acquirer’s existence.
- b. Accessions and deaccessions of noncapitalized collection items acquired with resources that are without donor restrictions.
- c. Equity transfers, unless they are not for current period use in carrying out the purpose for the reporting entity’s existence.

Net investment return (investment return less investment expenses) must be presented on the face of the Statement of Activities. Investment expenses must include both external and direct internal expenses. No requirement to disclose the gross investment income and expenses separately anymore.

FASB decided **not** to require disclosure of unrelated business income taxes or excise taxes that are netted against investment return and to **eliminate** the disclosure of:

- a. Components of investment return as both a separate disclosure and part of the endowment rollforward.
- b. The total performance of other investment portfolios that is currently required for institutions of higher education.

All NFPs must report operating expenses by both function and nature, either in a Statement of Functional Expenses, the Statement of Activities, or in the Notes to the Financial Statements. The method(s) used to allocate costs among program and support services functions must be described.

4. Proposed Changes to the Statement of Cash Flows

Cash flows from operations must be presented using the **direct method** (the exposure document will ask if the indirect method should be required for certain NFPs).

Certain cash flow items will be **recategorized** to better align “operating” activities with the Statement of Activities and the Overall Operating Measure, as described in the below table.

Cash Flow Items	Operating	Investing	Financing
Interest and dividends	Old	New	—
Interest on long-term debt	Old	—	New
Purchases of PP&E and collection items	New	Old	—
Proceeds from sales of PP&E and collection items	New	Old	—
Contributions restricted to PP&E and collection items	New	—	Old

Contributions restricted to endowment will **continue** to be reported as a financing activity.



In addition to requiring the direct method, FASB is proposing a reorganization within the Statement of Cash Flows to better match the revamped Statement of Activities presentation.





The example Statement of Activities is presented in columnar form, as has been most prevalent in the past. Alternatively, it may be “stacked” to show net assets without donor restrictions first, followed by net assets with donor restrictions.

5. Proposed Transition

The proposed ASU will require **retroactive application** of the proposed changes. In the initial year of application, the annual financial statements would disclose the nature of any reclassifications or restatements and their effect, if any, on the change in the net asset classes for each year or period presented. Application to interim financial statements would not be required in the initial year of application

6. Illustrative Statements of Activities and Cash Flows

Below are illustrative Statements of Activities and Cash Flows included in the proposed ASU, which depict the application of the changes contained in the various provisions of the proposed ASU. A Statement of Financial Position is excluded here because changes relating to that statement are limited to the reduction of net asset classes from three to two as discussed above



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	<u>14,190</u>		<u>22,580</u>
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	<u>32,240</u>		<u>-</u>
Total revenues, gains, and other support without donor restrictions	<u>46,430</u>		
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	<u>31,588</u>		<u>31,588</u>
Fire loss	80		80
Total expenses and losses	<u>31,668</u>		<u>31,668</u>
Operating excess, before transfers	<u>14,762</u>		
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	<u>15,122</u>		
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	<u>19,058</u>	<u>(3,608)</u>	<u>15,450</u>
Net assets at beginning of year	<u>73,619</u>	<u>197,021</u>	<u>270,640</u>
Net assets at end of year	<u>\$ 92,677</u>	<u>\$ 193,413</u>	<u>\$286,090</u>



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

Cash flows from operating activities:

Cash received from service recipients	\$	5,220
Cash received from contributors, restricted for investment in land, buildings, equipment		1,210
Cash received from contributors, other		10,645
Proceeds on sale of equipment		200
Insurance proceeds from fire loss on building		250
Miscellaneous receipts		150
Cash paid to employees and retirees		(13,400)
Cash paid to suppliers		(5,858)
Grants paid		(5,175)
Purchase of equipment		(1,500)
Net cash used by operating activities		(8,258)

Cash flows from investing activities:

Interest and dividends received		8,870
Proceeds from sale of investments		76,100
Purchase of investments		(74,900)
Net cash provided by investing activities		10,070

Cash flows from financing activities:

Proceeds from contributions restricted for:		
Investment in endowment		200
Investment in term endowment		70
Investment subject to annuity agreements		200
Payments of annuity obligations		(145)
Payments of interest		(382)
Payments on notes payable		(1,140)
Payments on long-term debt		(1,000)
Net cash used by financing activities		(2,197)

Net decrease in cash and cash equivalents		(385)
Cash and cash equivalents at beginning of year		4,960
Cash and cash equivalents at end of year		\$ 4,575

Supplemental data for noncash operating, investing, and financing activities:

Gifts of equipment	\$	140
Gift of paid-up life insurance, cash surrender value		80

