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# Nonprofit Financial Statement Standards Implementation

ASU 2016-14

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6.28.18





## Financial Statements of Not-for-Profit Entities (ASU 2016-14)



## Financial Statements of Not-for-Profit Entities

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### Key Objectives

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
  - Financial performance
  - Cash flows
  - Liquidity
- Better enable NFPs to “tell their financial story”

## Financial Statements of Not-for-Profit Entities Phase One

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- The first of a two-phase project, the ASU is intended to improve presentation and disclosures and provide more relevant information about a not-for-profit (NFP) entity's resources and the changes in those resources to users of the financial statements.
- The new standard is intended to simplify how NFPs classify net assets and improve information provided about their liquidity, financial performance, expenses, and cash flows.
- Adoption of FASB ASU 2016-14 will result in significant changes to financial reporting for NFPs.

## Financial Statements of Not-for-Profit Entities Phase Two

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The second phase is expected to address more protracted issues surrounding whether and how to define the term "operations" and align measures of operations (of financial performance) as presented in a statement of activities with measures of operations in a statement of cash flows.

Phase I Aim: Final ASU by mid-2016, effective for calendar year 2018 (fiscal year 2018-19)	Phase II
<b>Net Asset Classes:</b> <ul style="list-style-type: none"> <li>• Classification scheme</li> <li>• Disclosure of board designated net assets</li> <li>• Underwater endowments</li> <li>• Expirations of capital restrictions</li> </ul>	<b>Operating Measures – all other elements of the proposal, including:</b> <ul style="list-style-type: none"> <li>• Whether to require intermediate measure(s)</li> <li>• Whether and how to define such measure(s), and what items should or should not be included in the measure(s)</li> <li>• Alternative disaggregation approaches suggested by stakeholders</li> </ul> <b>Statement of Cash Flows:</b> <ul style="list-style-type: none"> <li>• Realignment of certain items</li> </ul>
<b>Expenses/Investment Return:</b> <ul style="list-style-type: none"> <li>• Expenses by nature; analysis of expenses by function and nature</li> <li>• Netting of investment expenses against investment return</li> <li>• Disclosure of netted investment expenses</li> <li>• Enhanced disclosures about cost allocations</li> </ul>	
<b>Operating Measures:</b> <ul style="list-style-type: none"> <li>• Modest improvements to disclosures for those that use an operating measure, especially about board appropriations, designations, and similar transfers</li> </ul>	
<b>Liquidity/Availability:</b> <ul style="list-style-type: none"> <li>• Quantitative disclosures about availability</li> <li>• Qualitative disclosures about liquidity</li> <li>• Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet)</li> </ul>	
<b>Statement of Cash Flows:</b> <ul style="list-style-type: none"> <li>• Methods of presenting operating cash flows (direct/indirect)</li> </ul>	

## Key Phase I Changes (Amendments to Current GAAP)

- Allowing free choice between direct method and indirect method in presenting operating cash flows
- Improving presentation and disclosures for net asset classes
- Enhancing information about the liquidity and availability of financial resources
- Providing better information about expenses and expense allocation
- Improving reporting of investment return

## Project Objectives

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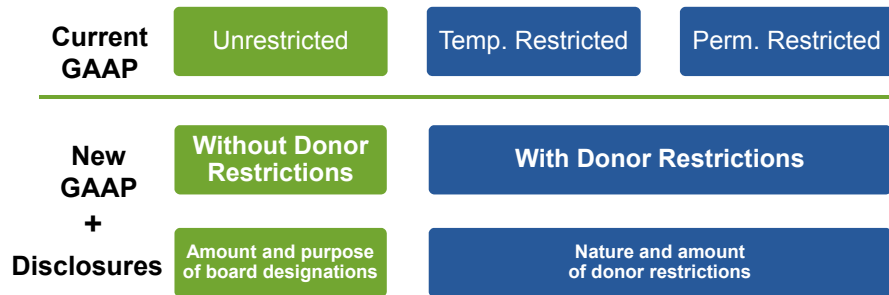
## Financial Statements of Not-for-Profit Entities

### Net Asset Classifications

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- On the face of the statement of financial position, temporarily and permanently restricted net assets are combined into net assets with donor restrictions
- Unrestricted net assets are renamed to “net assets without donor restrictions”
- Provide relevant information about the nature and amounts of donor restrictions on the face of the statement or in the notes
- The aggregate by which endowment funds are underwater would be classified within net assets with donor restrictions

## Financial Statements of Not-for-Profit Entities Net Asset Classifications (continued)



## One Statement Approach Statement of Activities

	Without Donor Restrictions	With Donor Restrictions	Total
<b>OPERATING ACTIVITIES</b>			
<b>Revenue and support:</b>			
Fees for services	\$ 495		\$ 495
Bequests	600		600
Other contributions	425	1,500	1,925
Restricted support released	1,375	(1,375)	
<b>Revenue and support</b>	<b>2,895</b>	<b>125</b>	<b>3,020</b>
<b>Expenses:</b>			
Expenses	1,950	-	1,950
<b>Revenues and support in excess of expenses before transfers</b>	<b>945</b>	<b>125</b>	<b>1,070</b>
<b>Transfers</b>			
Transfers to operating activities	150		150
Transfers from operating activities	(500)		(500)
<b>Revenues and support in excess of expenses after transfers</b>	<b>\$ 595</b>	<b>\$ 125</b>	<b>\$ 720</b>
<b>NONOPERATING ACTIVITIES</b>			
Interest expense	(75)		(75)
Investment return, net	170	445	615
<b>Transfers</b>			
Transfers to operating activities	(150)		(150)
Transfers from operating activities	500		500
	350		350
<b>Total change in net assets</b>	<b>1,040</b>	<b>570</b>	<b>1,610</b>
Net assets at the beginning of the period	1,500	2,100	3,600
<b>Net assets at the end of the period</b>	<b>\$ 2,540</b>	<b>\$ 2,670</b>	<b>\$ 5,210</b>

■ Operating ■ Nonoperating w/o donor restrictions ■ With donor restrictions

## “Underwater” Endowments

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### 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

## Expiration of Capital Restrictions

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- Gifts of cash restricted for acquisition or construction of PP&E
  - In absence of explicit donor restrictions, NFPs would be required to use the **placed-in-service** approach (*no more implied time restrictions*)
    - Healthcare NFPs are already required to do so

## Financial Statements of Not-for-Profit Entities Net Asset Classifications (continued)

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- Required to disclose the following for endowment funds that are underwater:
  - Policy to reduce expenditure or not spend from underwater endowment funds
  - Aggregate fair value
  - Aggregate original endowment gift amount or level required by donor stipulations, or law, to be maintained
  - Aggregate amount of deficiencies
- In the absence of explicit donor restrictions, required to reclassify *net assets with donor restrictions* that are for the acquisition or construction of long-lived assets as *net assets without donor restrictions* when the long-lived asset is placed-in-service

## Expense Reporting

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- Report expenses, either on the face of financial statements or in the notes, by:
  - Function\*
  - Natural classification
  - Analysis (disaggregate function by nature)\*\*

\* **Currently required in GAAP**

\*\* **Choice of location; Board may explore segment reporting instead for HC in Phase 2**



## Expense Reporting (continued)

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- NFPs required to provide qualitative disclosures about methods used to allocate costs among program and support functions
- ASU also provides enhanced guidance on allocations from M&G expenses
  - Key concept: ***direct conduct*** or ***direct supervision***

## Cost Methodology Issues

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Allocation	Current Cost Allocation Method	Revised Allocation Method
Facilities O&M	Sq. Footage basis	Service & effort estimate
Depreciation & amortization	Sq. Footage basis	No change
Interest	Usage of Space	No change
IT-related costs (allocation now required)	Did not allocate	Service & effort estimate (easier than thought)

## Financial Statements of Not-for-Profit Entities Expenses

Report all expenses (other than netted investment expenses) by function and nature in one location, either on the statement of activities, in a separate statement, or in the notes to the financial statements.

	Program Activities			Supporting Activities			Total Expenses	
	A	B	C	Programs Subtotal	Management and General	Fund-Raising		Supporting Subtotal
Salaries and benefits	\$ 7,400	\$3,900	\$ 1,725	\$ 13,025	\$ 1,130	\$ 960	\$ 2,090	\$ 15,115
Grants to other organizations	2,075	750	1,925	4,750				4,750
Supplies and travel	890	1,013	499	2,402	213	540	753	3,155
Services and professional fees	160	1,490	600	2,250	200	390	590	2,840
Office and occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,440	800	570	2,810	250	140	390	3,200
Interest	171	96	68	335	27	20	47	382
<b>Total expenses</b>	<b>\$13,296</b>	<b>\$8,649</b>	<b>\$ 5,837</b>	<b>\$ 27,782</b>	<b>\$ 2,038</b>	<b>\$2,150</b>	<b>\$ 4,188</b>	<b>\$ 31,970</b>

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation and office and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits, which are allocated on the basis of estimates of time and effort.

## Financial Statements of Not-for-Profit Entities Investment Return

- Required to present investment return net of external and direct internal investment expenses
- Not required to disclose internal salaries and benefits netted against return
- Permitted, but not required, to disclose any investment expenses netted against investment return
- No longer required to display the investment return components in the endowment net assets rollforward
- Not required to include external and direct internal investment expenses that have been netted against investment return in the functional expense analysis

## Financial Statements of Not-for-Profit Entities Operating Measures

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### Operating Measures

- NFPs that present a self-defined operating measure in the statement of activities and that also present internal board designations, appropriations, and similar actions on the face of the statements would be required to report internal transfers appropriately disaggregated and described either on the face or in the notes

## Financial Statements of Not-for-Profit Entities Information Useful in Assessing Liquidity

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### Information Useful in Assessing Liquidity

- Provide qualitative information in the notes that communicates how the NFP manages its liquid resources available to meet the cash needs for general expenditures within one year of the balance sheet date
- Provide quantitative information either on the balance sheet or in the notes that communicates the availability of the NFP's financial assets at the balance sheet date to meet the cash needs for general expenditures within one year of the balance sheet date (availability may be affected by the nature of the assets, external limits, internal limits)

## Disclosures on Liquidity and Availability

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NFP A has \$395,000 of financial assets available within one 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 certificates of deposit and short-term treasury instruments. As more fully described in Note X, 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.

NFP A's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. As described in Note Y, the quasi-endowment has a spending rate of 5%. \$1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.

## Disclosures on Liquidity and Availability

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As part of NFP 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, NFP A invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of \$20 million, which it could draw upon. Additionally, NFP A has a quasi-endowment of \$33 million. Although NFP A does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, amounts from its quasi-endowment could be made available if necessary. However, both the quasi-endowment and donor-restricted endowments contain investments with lock-up provisions that would reduce the total investments that could be made available (see Note X for disclosures about investments).

## Example: Quantitative Liquidity Disclosure

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### FASB ASC 958-205-55-21

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	(36,600)
Amounts set aside for liquidity reserve	(1,300)
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Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 5,370</u>

## Financial Statements of Not-for-Profit Entities Improving Disclosures and Statement of Cash Flows

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### Improving Disclosures

- Provide enhanced disclosures about the method(s) used to allocate costs among program and support functions

### Statement of Cash Flows

- No longer required to provide indirect reconciliation when choosing to use the direct method
- Allowed to use either the direct method or indirect method of presenting operating cash flows

## Indirect Method of Reporting Operating

Cash flows from operating activities:

Change in net assets	\$ 15,450
Adjustments to reconcile change in net assets to net cash used by operating activities:	
Depreciation	3,200
Fire loss	80
Actuarial loss on annuity trust obligations	30
Gain on sale of equipment	(200)
Increase in accounts and interest receivable	(460)
Decrease in inventories and prepaid expenses	390
Increase in contributions receivable	(325)
Increase in accounts payable	1,520
Decrease in refundable advance	(650)
Decrease in grants payable	(425)
Contributions restricted for long-term investment	(2,740)
Realized and unrealized gains on investments	(15,800)
Interest and dividends restricted for reinvestment	(300)
Net cash used by operating activities	<u>(230)</u>

## Direct Method of Reporting Operating

Cash flows from operating activities:

Cash received from service recipients	\$ 5,020
Cash received from contributors	8,030
Cash collected on promises to give	2,615
Interest and dividends received	8,570
Miscellaneous receipts	150
Cash paid to employees and retirees	(13,400)
Cash paid to suppliers	(5,658)
Interest paid	(382)
Grants paid	(5,175)
Net cash used by operating activities	<u>(230)</u>



## Helping You with Implementation

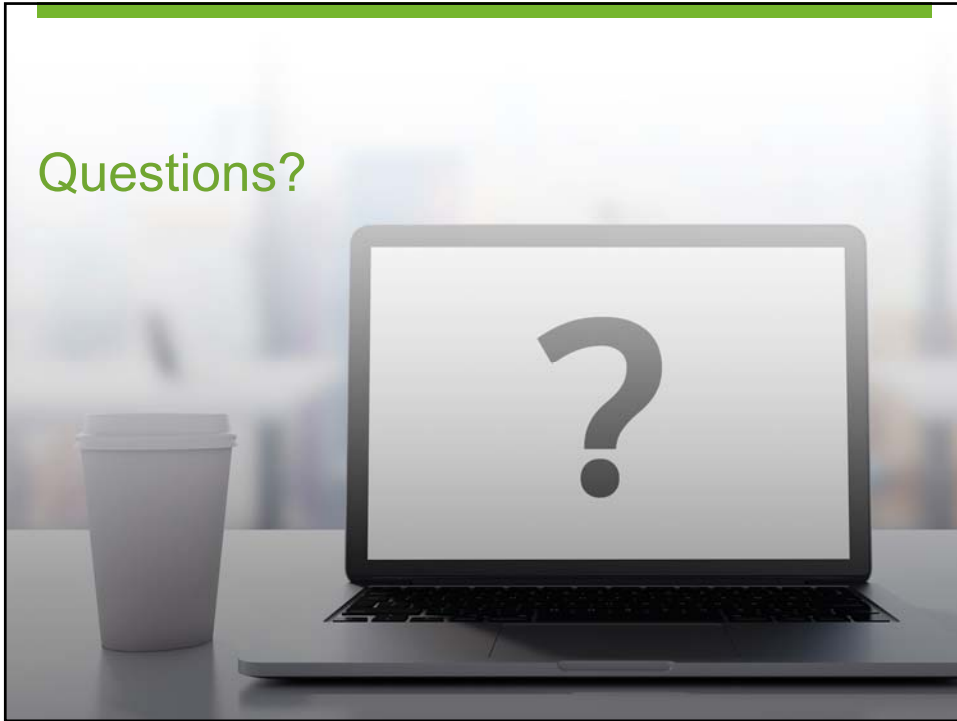


## Financial Statements of Not-for-Profit Entities Transition Method and Effective Date

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- Effective for fiscal years beginning after December 31, 2017, with early adoption permitted
- Create an implementation plan
  - Check your liquidity
  - Check your ratios
  - Consider effects on prior-year financial statements
  - Consider whether you want to make other format changes
- Comparative statements in year of adoption
  - For prior years, can choose to not present the following (unless already required to do so under GAAP):
    - Analysis of expenses by nature and function
    - Disclosures about liquidity and availability of resources

Questions?



Thank you!

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