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The Presentation of Financial Statements of Not-for-Profit Entities is Changing

By Justin Elanjian, assurance senior manager

In August 2016, the Financial Accounting Standards Board (FASB) released Accounting Standards Update (ASU) 2016-14 Not-for-Profit Entities (Subtopic 958): Presentation of Financial Statements of Not-for-Profit Entities. ASU 2016-14 changes a financial reporting framework that has been in place for 20 years, but despite its 270 pages, it's not as intimidating as it seems. This accounting standard update is an update, not an overhaul. ASU 2016-14 aims to improve how not-for-profit organizations (NFPs) communicate their financial performance and condition, while also reducing complexities in preparing financial statements. The changes in presentation will provide users of the financial statements more useful information while enabling NFPs to better tell their financial story.

So here's what you need to know about this new guidance:

> The changes in presentation will provide users of the financial statements more useful information while enabling NFPs to better tell their financial story.

THE THREE CHANGES NFPS NEED TO KNOW

While ASU 2016-14 has several changes to presentation and defined terms, there are three primary changes you need to know:

1. Net Asset Classification
2. Functional Expenses
3. Liquidity

Net Asset Classification – the new standard takes the existing three classes of net assets (unrestricted, temporarily restricted and permanently restricted) down to two (with donor restrictions and without donor restrictions). This change further emphasizes that restrictions are those imposed by a third-party, as opposed to management or the board. But don't think NFPs are getting off that easy. In addition to reducing the number of net asset categories, the new standard requires the presentation and disclosure of board-designated net assets (a new term included in ASU 2016-14), which was previously voluntary. With a reduced number of asset classes, NFPs will focus on disaggregating and disclosing the components of their net asset classes with enhancing disclosures.

Functional Expenses – the new standard will require three things related to the reporting of expenses: reporting by function (currently required), natural classification and the methodology used for said allocations. At the current time, only voluntary health and welfare entities are required to report expenses by function and natural classification, but the usefulness of this information means it will now be required for all NFPs. The reporting of expenses by function is no more than allocating expenses between program, general and administrative, and fundraising. However, the reporting of expenses by natural classification provides further details of the expenses incurred by NFPs, as it will identify the amounts paid for salaries, professional fees, office expenses, etc. While all NFPs that file a Form 990 or Form 990-EZ go through this exercise at some point, it will now be a required component of the financial statements. With that being said, the new standard is not suggesting every line item on the Form 990 or Form 990-EZ be presented separately in the financial statements. The extent to which expenses should be disaggregated should be based on both materiality and the relevance of information to users of the financial statements.

Liquidity – perhaps the most significant change from current practice, the new requirement for information regarding liquidity entails both quantitative and qualitative information. Presentation of quantitative information may come in the form of a classified balance sheet or footnote disclosure. The quantitative aspect should provide information regarding the availability of financial assets to meet cash needs for general expenditures within one year of the balance sheet date. On the other hand, the qualitative information includes how an NFP manages its liquid resourcesto meet cash needs for general expenditures within one year of the balance sheet date. General expenditures here means restricted funds or long-term assets not included in the liquidity analysis.

When is ASU 2016-14 effective?

ASU 2016-14 is effective for financial statements issued for fiscal years beginning after Dec. 15, 2017; however, early adoption is permitted.

What should NFPs be doing now?

With the effective date so far out, it may seem like consideration of the impact of ASU 2016-14 can be put on the back burner, but we would advise preparing in advance. With enhanced and/or new disclosures regarding expense allocation methods, liquidity analysis and board-designated net assets, revisit your processes and policies in place now (or implement them if there are no formal policies in effect today). Consulting with the users of your financial statements, management and your auditors (both internal and external) is a great place to start.

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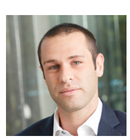
For more information about ASU 2016-14, including designing a plan for implementation or questions on how to apply the standard, contact:



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