Recent Accounting Changes Effecting All Not-For-Profit Organizations

<u>Introduction</u>

Within the last few years the Financial Accounting Standards Board (FASB), the rule making body that approves all changes to Generally Accepted Accounting Principles (GAAP), has issued several major accounting and reporting revisions that effect every Not-For-Profit organization in the country. Some of these changes are the most significant Not-For-Profit changes issued since 1994.

The following is a summary of the most significant changes. The effective dates for these changes are listed on the last page.

Presentation of Financial Statements of Not-For-Profit Entities (ASU 2016-14)

After several years of discussion, the FASB issued Accounting Standards Update (ASU) 2016-14 called "*Presentation of Financial Statements of Not-for-Profit Entities*". This update is effective for most Not-for-Profit (NFP) organizations for annual financial statements issued for fiscal years beginning after December 15, 2017. Early adoption is allowed. The major changes in this update can be grouped into the following six major areas:

1. Net Asset Classification

Currently, an organization is required to report their net assets (i.e. total assets minus total liabilities) under three classifications: unrestricted, temporarily restricted and permanently restricted. These three classes have been replaced with two classes: *Net Assets With Donor Restrictions* and *Net Assets Without Donor Restrictions*. In addition, organizations are required to provide additional disclosures about both the nature and amounts of Net Assets With Donor Restrictions on either the face of the financial statements or in the Notes to the financial statements. Organizations are also required to disclose any Board designated restricted net assets.

This change will affect how changes and balances in both net asset classes are reported on the Statement of Financial Position and Statement of Activities.

2. Expense Reporting

Currently only Voluntary Health and Welfare Organizations (VHWO), a subset of public charities, are required to present expense information by both their function (programmatic and supporting services like management & general or fundraising) and by nature (e.g. salaries, rent, supplies, etc.). This was typically presented in a two-dimensional report called a statement or schedule of functional expenses. Under the new rules, all organizations will be required to provide an analysis of operating expenses by both functional and natural classification in a single location which can either be in the notes or as a separate, stand-alone report. A disclosure must also be included that explains how expenses are allocated among functions.

3. Statement of Cash Flows

Currently an organization can present its statement of cash flows using either the direct or indirect method. The update states that an organization can continue using either method. However, if they decide to use the direct method, they are no longer required to provide an indirect reconciliation but still can if they choose to.

4. Underwater Endowments

To better align with the Uniform Prudent Management of Institutional Funds Act which has be approved in some measure by 49 states and the District of Columbia and U.S. Virgin Islands, rather than reducing unrestricted net assets for amounts by which endowment funds are underwater (i.e. current value is less than original value), the new rules require that those differences be reported with the net assets with donor restrictions. Organizations will be required to disclose their policy for spending on underwater endowments and the aggregate original gift amounts of underwater funds, along with the fair value of those funds. More specifically they must disclose - (1) appropriation during year of underwater funds, (2) aggregate fair value of funds, (3) aggregate of original gift amount and (4) aggregate amount that is underwater.

5. Liquidity and Availability of Financial Assets

Organizations will be required to provide both quantitative and qualitative information in the notes to the financial statements that communicates the availability of an NFP's financial assets at period end to meet its cash needs for general expenditures within one year. The availability will be affected by internal restrictions placed on those assets by the organization's governing Board or by external restrictions imposed by contract, law, donors or grantors.

6. Other Provisions

Investment Expenses – Currently an organization must disclose the amount of investment expenses that was netted again investment income. The new rules have done away with this requirement and investment returns must now be presented net of external and direct internal expenses/fees. In addition, NFPs are no longer required to display the investment return components (i.e. income earned and net realized and unrealized gains and losses) in the roll-forward of endowment net assets

Donation of Long Lived Assets are now considered unrestricted when an asset is placed in service. As such, an organization is no longer allowed to match the release of restriction to the ratable depreciation of the asset.

Cash Restricted By Donor or Board – Cash restricted by a donor or the Board should not be classified with cash without donor restriction and available for current use and should be separated and described on the Statement of Financial Position.

Going Concern (ASU 2014-15)

Under the prior rules it was the auditor's responsibility during a financial audit to determine whether an organization has the ability to continue as a going concern and if not disclose in the auditors' report that there is a going concern. Under the new rules, management is now required to evaluate whether it is probable that the organization will not be able to meet its obligations as they become due within one year after date of financial statements are issued or available to be issued. If management determines that there is a going concern then management must disclose how it plans to alleviate the substantial doubt. The new rules require the auditor to evaluate management's assertions and comment on whether they agree or disagree with management's assertions.

Revenue From Contracts with Customers (ASU 2014-09)

The new rule establishes a single, principles-based revenue standard that provides specific details on when an organization should record revenue from services provided or sales of products. It focuses on contracts with customers, except lease contracts, insurance contracts, financial instruments, guarantees and certain nonmonetary exchange such as contributions. The organization must apply the following five steps to determine if each transaction qualifies: (1) Identify the contract(s) with the customer; (2) Identify the performance obligations; (3) Determine the transaction price; (4) Allocate the transaction price to the performance obligations; and (5) Recognize revenue when (or as) a performance obligation is satisfied.

Leases (ASU 2016-02)

On February 25, 2016 the FASB issued an Accounting Standard Update (ASU) that changes the way an Organization is to account for leased assets such as office space. Prior to this update organizations were only required to disclose in the notes to the financial statements the total amount of the leased obligation (i.e. operating lease). The new rule will require organizations that lease assets (referred to as "lessees") to recognize on their balance sheet the assets and liabilities for the rights and obligations created by those leases.

Effective Dates

Presentation of Financial Statements of Not-For-Profit Entities (ASU 2016-14)	Fiscal Year Beginning after 12/15/17
Going Concern (ASU 2014-15)	Fiscal Year Ending after 12/15/16
Revenue From Contracts with Customers (ASU 2014-09)	Fiscal Year Beginning after 12/15/18
Leases (ASU 2016-02)	Fiscal Year Beginning after 12/15/19