March 2018

Not-for-Profit Financial Reporting Guidelines

Introduction

Johnson Lambert LLP is dedicated to keeping you updated on the impact the Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* will have on your financial statements. This white paper presents the most significant changes, which are effective for annual financial statements issued for fiscal years after December 15, 2017.

Background

In 2009, the FASB formed the Not-for-Profit (NFP) Advisory Committee (NAC) to advise the FASB on NFP matters. Through its outreach, the NAC determined the existing financial reporting standards were sound and concluded that NFPs needed better options to present financial information and results and an opportunity to better communicate accomplishments to their members, donors and other stakeholders. To meet these goals, FASB decided to divide the improvements into two projects:

- Financial Reporting Model - ASU 2016-14
- Financial Performance Reporting, to address whether to require and how to define a measure of operations (project in progress)

Overview

In August 2016, the FASB issued ASU 2016-14. The amendments are required to be applied retrospectively in the year of adoption, except for the analysis of expenses by natural and functional classification and disclosures about the liquidity and availability of resources.

ASU 2016-14 improves and enhances the information provided in the financial statements and notes to the financial statements as follows:

- Simplifies the classification of net assets and enhances note disclosures
- Requires additional disclosures to provide insight into the management and liquidity of an NFP's financial assets
- Makes expense information more comparable among NFPs

Summary of Key Provisions

The ASU focuses on seven key provisions:

Net Asset Classification

- Net assets are classified as net assets without donor restrictions or net assets with donor restrictions
- Enhances disclosures for NFP-imposed limits on the use of net assets without donor restrictions

Liquidity and Availability of Resources

- Disclose qualitative and quantitative information regarding the management, liquidity and availability of an NFP's financial assets to meet general expenditure needs within one year of the statement of financial position

Underwater Endowment Funds

- Reported net of deficiencies and classified as net assets with donor restrictions
- Disclose aggregate information regarding fair value, amount of deficiencies and amount of original endowment gift or level required to be maintained

Expenses

- Present and analyze all expenses by nature and function

Investment Return

- Investment returns are presented net of external and direct internal investment expenses
- Make certain disclosures regarding investment return optional

Statement of Cash Flows

- Eliminate the requirement to present the indirect reconciliation if using the direct method

Release of Restrictions on Capital Assets

- The "placed in service" approach should be used to report expirations of restrictions on gifts of long-lived assets and cash or other assets used to acquire or construct long-lived assets, absent explicit donor stipulations

ASU Implementation Details

Net Asset Classification

Net assets are now classified as net assets without donor restrictions or net assets with donor restrictions. Net assets previously classified as unrestricted net assets are classified as net assets without donor restrictions. Net assets previously classified as temporarily restricted or permanently restricted are classified as net assets with donor restrictions. The two-level classification intends to reduce complexity and confusion for financial statement users in understanding when temporarily restricted net assets become available for use by the NFP.

NFPs should disclose information regarding the purposes and periods of donor restricted net assets as well as information about how the restrictions affect the use of resources. This information may be disclosed in the notes to the financial statements, as seen in Exhibit A on the following page, or presented on the face of the statement of financial position.

Exhibit A: Net Assets with Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes or periods:

	6/30/20X1 (in thousands)
Subject to the expenditure for specified purpose:	
Program A activities:	
Purchase of equipment	$ 3,060
Research	950
Educational seminars and publications	240
Program B activities:	
Disaster relief	745
Educational seminars and publications	280
Program C activities: general	210
Building and equipment	2,150
Annuity trust agreements for research	2,815
	10,450
Subject to the passage of time:	
For periods after June 30, 20X1	**3,140**
Subject to NFP spending policy and appropriation:	
Investment in perpetuity (including amounts above original gift amount of $122,337), which, once appropriated, is expendable to support:	
Program A activities	33,300
Program B activities	15,820
Program C activities	16,480
Any activities of the organization	109,100
	174,700
Subject to appropriation and expenditure when a specified event occurs:	
Endowment requiring income to be added to original gift until fund's value is $2,500	2,120
Paid-up life insurance policy that will provide proceeds upon death of insured for an endowment to support general activities	80
	2,200
Not subject to appropriation or expenditure:	
Land required to be used as a recreation area	**3,000**
Total net assets with donor restrictions	**$ 193,490**

NFPs should also disclose the amounts and purposes of self-imposed limits on net assets without donor restrictions resulting from governing board designations, appropriations or other similar actions as seen in Exhibit B.

Exhibit B: Net Assets without Donor Restrictions

The governing board has designated, from net assets without donor restrictions totaling $92,600, net assets for the following purposes:

	6/30/20X1 (in thousands)
Quasi-endowment	$ 36,600
Liquidity reserve	1,300
Total Board Designated Net Assets	**$ 37,900**

Liquidity and Availability of Resources

The following information regarding the liquidity and availability of an NFP's resources should be disclosed:

- Qualitative information regarding how the NFP manages its liquid resources to ensure it meets its general expenditure cash needs within one year of the date of the statement of financial position. If one does not exist, a formal liquidity management policy should be developed and disclosed.
- Quantitative information, and if necessary qualitative information, that discusses the availability of financial assets as of the date of the statement of financial position to meet general expenditure cash needs within one year of the date of the statement of financial position.

This information provides insight into:

- The effects of externally and internally imposed limits on the use of resources, resource availability and liquidity
- How an NFP manages liquidity to meet short term demands for cash
- The types of resources used and how they are allocated in carrying out the NFP's mission and exempt purpose

ASU 2016-14 notes the availability of financial assets may be affected by three factors. The following table lists those factors and examples of financial assets that could be affected. NFPs should carefully assess whether their financial assets are affected by these factors, which will require judgment and consultation with third parties and NFP employees.

Factor	Affected Financial Assets
Nature	• Contributions receivable over 12 months • Accounts receivable • Illiquid investments
External limits imposed by donors, grantors, laws and contracts with others	• Perpetually restricted endowment financial assets • Donor imposed programmatic restrictions • Trust and life income funds • Contracts with legal restrictions
Internal limits imposed by governing board decisions	• Board designated net assets • Quasi endowments

The ASU provides flexibility in disclosing quantitative information. Quantitative information may be disclosed in a tabular format as either a reconciliation (Exhibit C) or listing (Exhibit D), or a narrative format (Exhibit E) showing the NFP's financial assets available to meet operating expenditures within one year of the date of the statement of financial position. Additional qualitative information should be disclosed in the notes to the financial statements. In limited instances, a narrative disclosure may be sufficient to satisfy both the quantitative and qualitative requirements.

Exhibit C: Liquidity Disclosure - Option 1
Financial Assets Unavailable

The following reflects financial assets as of the balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date. Amounts not available include amounts set aside for long-term investing in the quasi-endowment that could be drawn upon if the governing board approves that action. However, amounts already appropriated from either the donor-restricted endowment or the quasi-endowment for general expenditures within one year of the balance sheet date have not been subtracted as unavailable:

	6/30/20X1 (in thousands)
Financial assets, at year-end	$ 234,410
Less those unavailable for general expenditure within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with purpose restriction	(10,450)
Subject to appropriation and satisfaction of donor restrictions	(174,700)
Board designations:	
Quasi-endowment fund, for long-term investing	(36,600)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	**$ 11,360**

Qualitative Disclosure

The NFP is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, the NFP must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of the NFP'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, the NFP invests cash in excess of daily requirements in short-term investments, including certificates of deposits and short term treasury instruments. Occasionally, the board designates a portion of any operating surplus to its liquidity reserve, which was $1,300 as of June 30, 20X1. There is a fund established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, the NFP also could draw upon $10,000 of available lines of credit or its quasi-endowment fund.

Exhibit D: Liquidity Disclosure - Option 2
Financial Assets Available

The NFP's financial assets available within one year of the balance sheet date for general expenditures are as follows:

	6/30/20X1 (in thousands)
Current Assets:	
Cash and cash equivalents	$ 4,575
Accounts and interest receivable	2,130
Contributions receivable	1,825
Short-term investments	1,400
Long-term investments appropriated for current use	1,430
Financial assets available to meet cash needs for general expenditures within one year	**$ 11,360**

Qualitative Disclosure

The NFP is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, the NFP must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of the NFP'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, the NFP invests cash in excess of daily requirements in short-term investments, including certificates of deposits and short-term treasury instruments. Occasionally, the board designates a portion of any operating surplus to its liquidity reserve, which was $1,300 as of June 30, 20X1. There is a fund established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, the NFP also could draw upon $10,000 of available lines of credit or its quasi-endowment fund.

Exhibit E: Liquidity Disclosure - Option 3
Narrative Only

Quantitative and Qualitative Disclosure

The NFP has $11,360 of financial assets available within one year of the balance sheet date to meet cash needs for general expenditure consisting of cash of $4,575, contributions receivable of $1,825, accounts and interest receivable of $2,130, short-term investments of $1,400 and long-term investments appropriated for current use of $1,430. 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. The NFP has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, the NFP invests cash in excess of daily requirements in various short-term investments including, certificate of deposits and short term treasury instruments. Occasionally, the board designates a portion of any operating surplus to its liquidity reserve, which was $1,300 as of June 30, 20X1. There is a fund established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of unanticipated liquidity needs the NFP also could draw upon $10,000 of available lines of credit or its quasi-endowment fund.

Underwater Endowment Funds

The FASB defines an underwater endowment fund as "a donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions." Such fund balances will be reduced by any deficits and reported as net assets with donor restrictions. The following disclosures are required to help financial statement users understand the impact of underwater endowment funds of the NFP:

- The governing board's interpretation of the law(s) affecting the ability to spend from underwater endowment funds
- The NFP's policy(s) for spending from underwater endowment funds and any appropriations from underwater endowment funds
- The aggregate fair value of underwater endowment funds
- The original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions, in the aggregate
- The aggregate amount of the deficiencies of the underwater endowment funds

Expenses

All NFPs should provide an analysis of expenses by nature and function, which may be reported in:

- The statement of activities
- The notes to the financial statements
- A separate financial statement

Expenses should be reported by major classes of program services and supporting activities. ASU 2016-14 clarifies that payroll, employee benefits management and oversight, and contract administration and financial reporting are included within management and general activities. However, the standard specifies that activities representing direct conduct or supervision of program and other supporting activities should be allocated from management and general activities to the program or support functions that receive a benefit. For example, if the Chief Executive Officer spends 25% of their time directly overseeing a specific research program or fundraising function, 25% of their compensation and benefits should be allocated directly to that research program or fundraising function. Conversely, the portion of compensation and benefits related to indirect supervision of program or support functions should remain in management and general activities.

Furthermore, costs that benefit multiple functions should be allocated amongst those functions. The allocation method used should be disclosed in the notes to the financial statements, either in a narrative or tabular format. Exhibit F is a sample illustration of the expense analysis by nature and function and disclosure of the expense allocation method.

Exhibit F: Functional Expenses
Not-for-Profit Statement of Functional Expenses
June 30, 20X1

	Program Activities (in thousands)				Supporting Activities (in thousands)			
	A	B	C	Programs Total	Management & General	Fundraising	Supporting Subtotal	Total Expenses
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
Total Expenses	**$ 13,296**	**$ 8,649**	**$ 5,837**	**$ 27,782**	**$ 2,038**	**$ 2,150**	**$ 4,188**	**$ 31,970**

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, interest, and office and occupancy, which are allocated on a square-footage basis, as well as salaries and benefits, which are allocated on the basis of estimates of time and effort.

Investment Return

Investment returns should be presented net of external and direct internal investment expenses. Direct internal investment expenses include, but are not limited to, the salary and benefits of the officer and/or staff responsible for the NFP's investment strategy and the selection and oversight of external investment management firms. Endowment management costs are specifically excluded from direct internal investment expenses. Investment expenses netted from investment returns should be excluded from the expense analysis described above.

The following disclosures regarding investment return, are now optional:

- Investment income separately from net appreciation or depreciation of investments
- Composition of investment return
- Reconciliation of investment return to amounts reported in the statement of activities if investment return is presented separately between operating and nonoperating

Statement of Cash Flows

NFPs may continue to present the statement of cash flows using the direct or indirect method. NFPs using the direct method are no longer required to provide the reconciliation of the change in net assets to net cash flow from operating activities.

Release of Restrictions on Capital Assets

ASU 2016-14 eliminates the option to adopt a policy to imply a time restriction that expires over the useful life of donated long-lived asset. Absent donor restrictions stating otherwise, NFPs that receive gifts of cash or other assets to purchase or construct long-lived assets should use the "placed in service" approach to report the expiration of restrictions. In the year ASU 2016-14 is adopted, existing long-lived assets that were placed in service and recorded as temporarily or permanently restricted should be reclassified to net assets without donor restrictions.

The content contained herein should not be relied upon as accounting or tax advice because it does not take into account any specific organization's facts and circumstances.