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Financial Statements of Not-for-Profit Entities

This presentation has been prepared to help stakeholders understand the current status of the NFP project of the FASB. The views expressed in this presentation are those of the presenters. Official positions of the FASB are reached only after extensive due process and deliberations.

Discussion Agenda

- **Background**
  - Project history and objectives
  - Project scope and touchstones
- **Key elements of the Proposal**
  - Net asset classes
  - Liquidity information
  - Activity statement
    - Operating measures
    - Reporting of expenses
  - Cash flow statement
- **Project timeline and next steps**

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NFP Financial Statement Model

- **Last overhauled approximately 20 years ago**
  - FAS 117 (now codified within Topic 958 of the ASC)
- **Represented significant change from previous guidance**
  - Significant differences across the sector
  - Significant differences from business entities
- **Standards kept at a somewhat high level, with expectation that guidance would evolve in certain areas (e.g., operating measure)**
  - Has happened, but only to a certain degree

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NFP Financial Statements Project – Key Objectives (recommended by FASB's NFP Advisory Committee (NAC))

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

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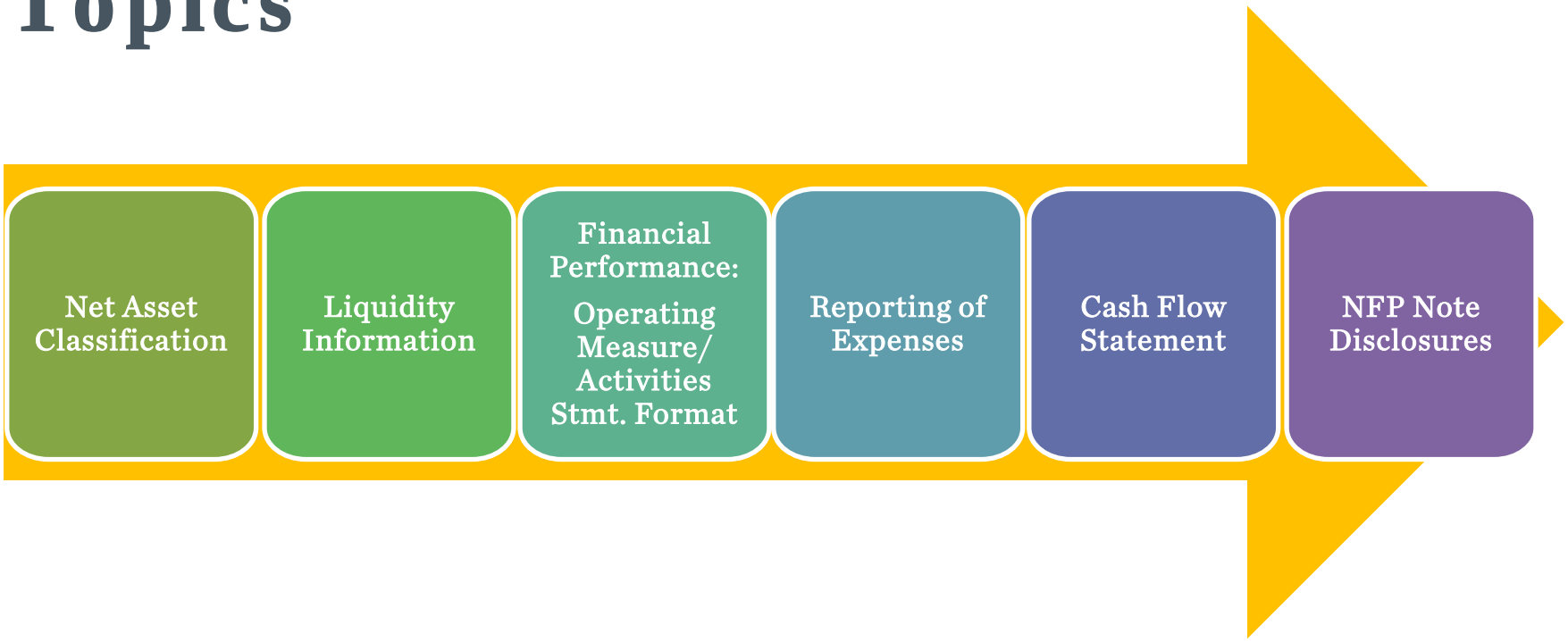
Financial Statements of NFPs – Topics



NOTE: Board removed NFP Other Financial Communications (MD&A) project from its research agenda in January 2014.

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Net Assets

Current GAAP	Unrestricted	Temp. Restricted	Perm. Restricted
Proposed GAAP	**Without Donor Restrictions**	**With Donor Restrictions**	
+			
Disclosures	**Amount, purpose, and type of board designations ***	**Nature and amount of donor restrictions**	

*** New disclosure requirement**

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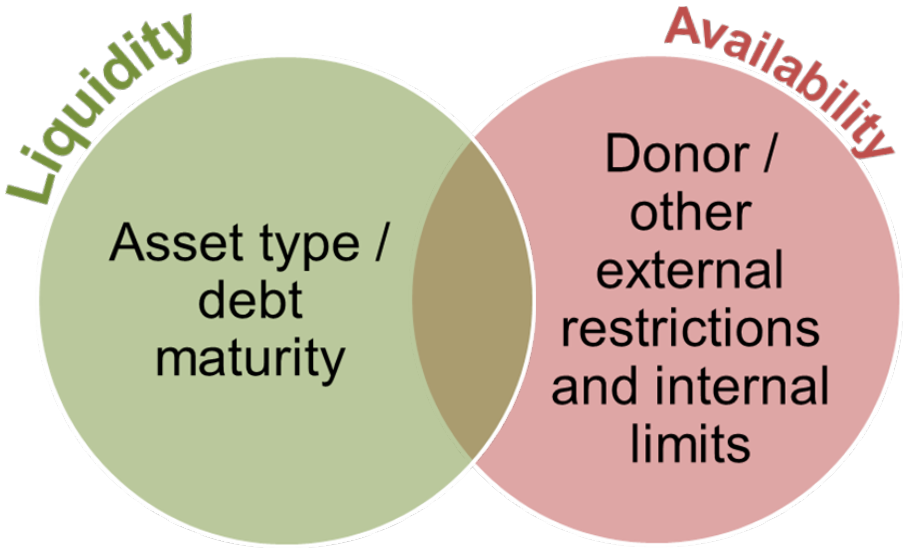
Liquidity and Financial Availability



FASB discussed:

- Classified balance sheet
- Separate presentation of assets whose use is limited
- Additional note disclosure

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Liquidity

The Board decided that an entity should define the time horizon it uses to manage its liquidity (for example, 30, 60, or 90 days) and disclose the following information:

1. **Quantitative information** about:
   a) The total amount of financial assets
   b) Amounts that are not available to meet cash needs within the time horizon because of (1) external limits and (2) internal actions of a governing board
   c) The total amount of financial liabilities that are due within that time horizon.

2. **Qualitative information** about how the entity manages its liquidity. For example, an entity might disclose**:**
   a) Its strategy for addressing entity-wide risks that may affect liquidity, including its use of lines of credit
   b) Its policy for establishing liquidity reserves
   c) Its basis for determining the time horizon used for managing liquidity.

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“Underwater” Endowments

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 decision to reduce or not spend from such funds.

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Financial Performance: Operating Measures

Defined **required** intermediate operating measures for all NFPs—based on two dimensions:

Tension Points:

Internal Actions

Capital-like Transactions

Mission (Business & Charitable Activity):
based on whether resources are from or directed at carrying out an NFP's purpose for existence (vs. investing and financing)

Availability:
based on whether resources are available for current period activities and reflecting limits imposed by:

-external donors

-internal actions of an NFP's governing board

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Financial Performance: Operating Measures

Require all available revenues separate from and before board designations

Requires subtotals both before and after board designations

Remove req. that if an operating measure is presented, then the change in unrestricted net assets must be shown

(ASC 958-225-45-10)

NFP business-oriented health care entities
no longer required to present the performance indicator

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Presentation of Transfers

Board reasoning is to:

1. Foster greater comparability across NFPs and within each industry,
2. While allowing flexibility for NFPs to tell their financial story.

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Presentation of Transfers (cont'd)

If transfers are used to reflect internal actions, NFP would present:

1. An operating measure before transfers that reflects all legally available amounts generated by or used in operations of the current period, including effects of donor restrictions and their expiration.

2. All internal transfers (decisions to designate otherwise available amounts as unavailable, or vice versa) in a discrete section after the subtotal, but before the operating measure after transfers.
   - With appropriate labeling/disclosure (one-time vs. ongoing policy; interrelation to net asset designations)

3. At a minimum, present aggregated line items of transfers from and transfers to operating activities
   - Provide details in a note unless all transfers are presented as discrete line items on the face

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Statement of Activities – Transfers

Without Donor Restrictions—Operating (Charitable and Business)

XXX ← **Operating excess (deficit) before transfers**

XXX ← Transfers to operating activities

(XXX) ← (Transfers from operating activities)

XXX ← **Operating excess (deficit) after transfers**

Present below operating or in a 2nd statement

Without Donor Restrictions—Nonoperating (Investing and Financing)

XXX ← Transfers from operating activities

(XXX) ← (Transfers to operating activities)

XXX ← **Δ in w/o donor restrictions**

Present below or to the right of operating; or in a 2nd statement

With Donor Restrictions (below or to the right of operating, or in a second statement*)

XXX ← **Δ in w/ donor restrictions**

XXX ← **Δ in w/ donor restrictions**

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Statement of Activities – Donor Endowment

Without Donor Restrictions—Operating (Charitable and Business)

XXX ← Endowment appropriation and release from restrictions

XXX

XXX

Operating excess (deficit) <u>before</u> transfers

Without Donor Restrictions—Nonoperating (Investing and Financing)

XXX

With Donor Restrictions

XXX ← Contributions

XXX ← Investment return, net

(XXX) ← Endowment appropriation and release from restrictions

XXX

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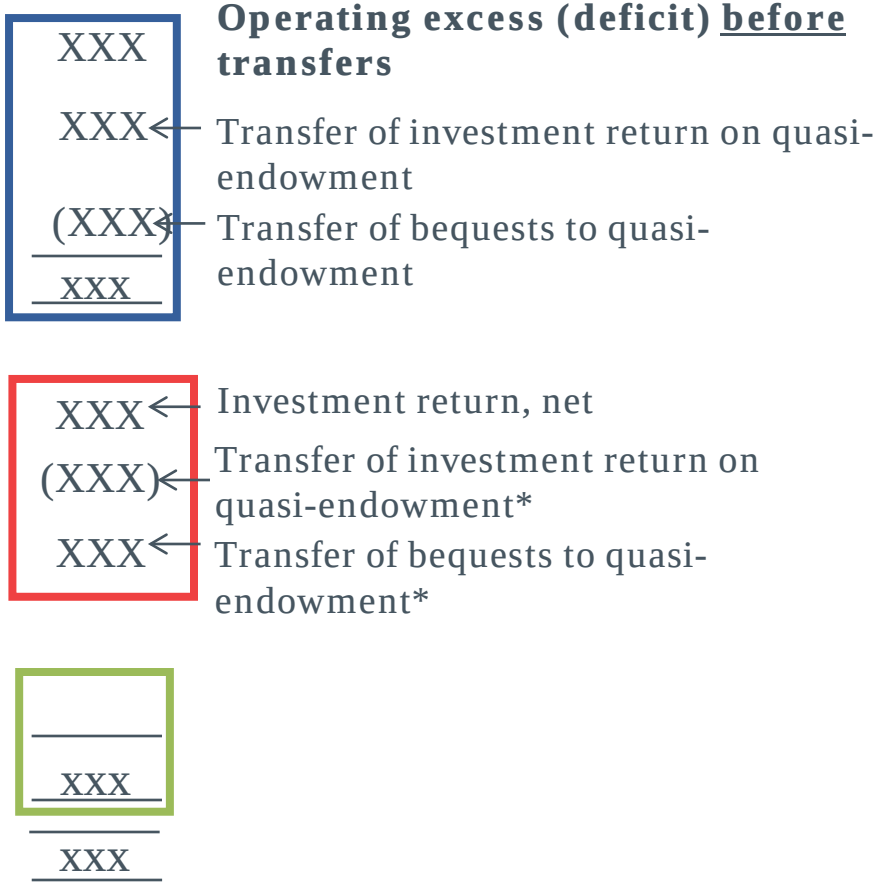
Statement of Activities – Quasi-Endowment

Without Donor Restrictions—Operating (Charitable and Business)

Without Donor Restrictions—Nonoperating (Investing and Financing)

With Donor Restrictions



* Minimum requirement would be to show all (a) transfers to and (b) transfers from operating activities, with further details in the notes.

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Capital-Like Transactions and Events

Gifts of long-lived assets without donor restrictions	By placing a gift of a long-lived asset in service (rather than selling it), the entity effectively makes the economic benefit of the gifted asset **unavailable** for current operations. Initial period: all unrestricted gifts are reported *within* operations. If the asset is placed in service, the entity would report a transfer *out* of current operations for the entire amount of the gifted asset
Gifts of cash restricted for acquisition or construction of long-lived assets	Initial period: reported as revenues that increase net assets *with* donor restrictions Release of donor restriction *within* operations and report a transfer *out* of current operations for the entire gifted amount (consistent with gifts of long-lived assets)

NFP would be required to use the **placed-in-service** approach

Noncapitalized collection accessions/deaccessions are considered **operating activities**

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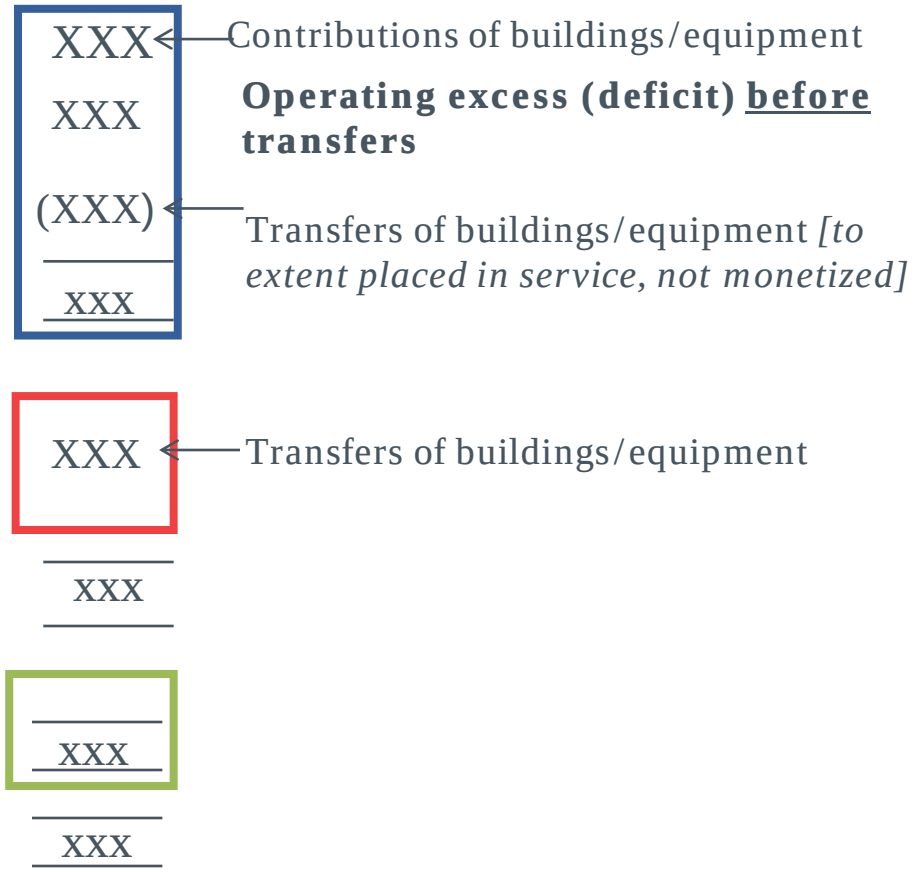
Statement of Activities – Gifts of PP&E

Without Donor Restrictions—Operating (Charitable and Business)

Without Donor Restrictions—Nonoperating (Investing and Financing)

With Donor Restrictions



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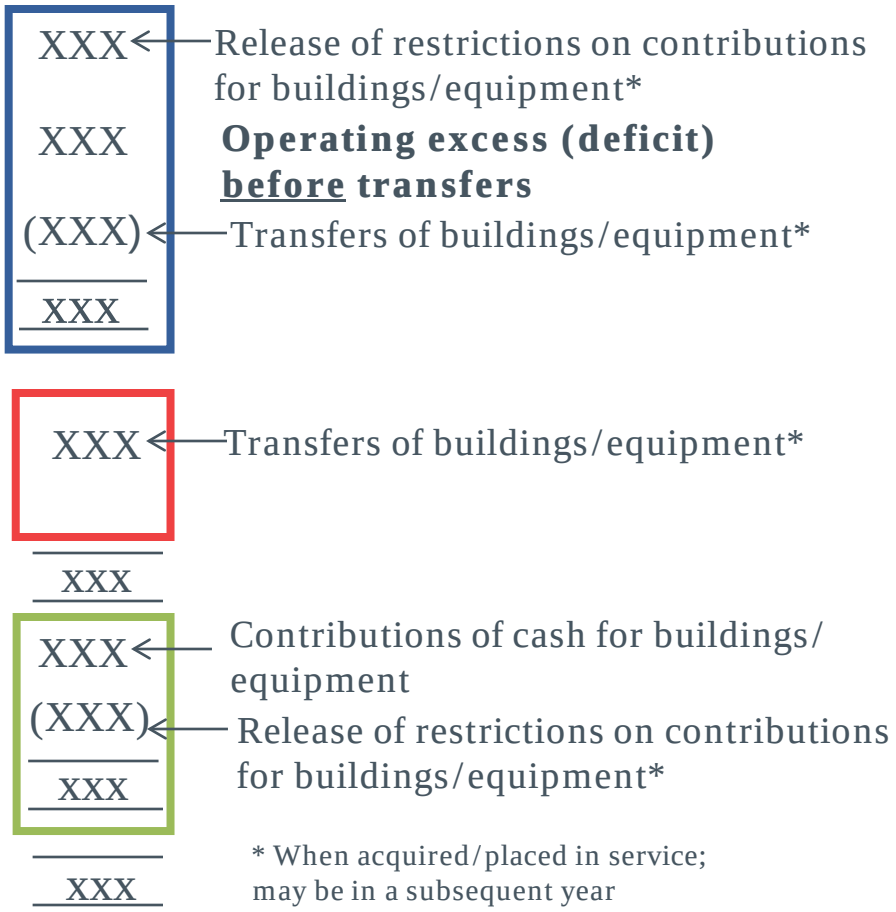
Statement of Activities – Gifts of Cash for PP&E

Without Donor Restrictions—Operating (Charitable and Business)

Without Donor Restrictions—Nonoperating (Investing and Financing)

With Donor Restrictions



* When acquired/placed in service; may be in a subsequent year

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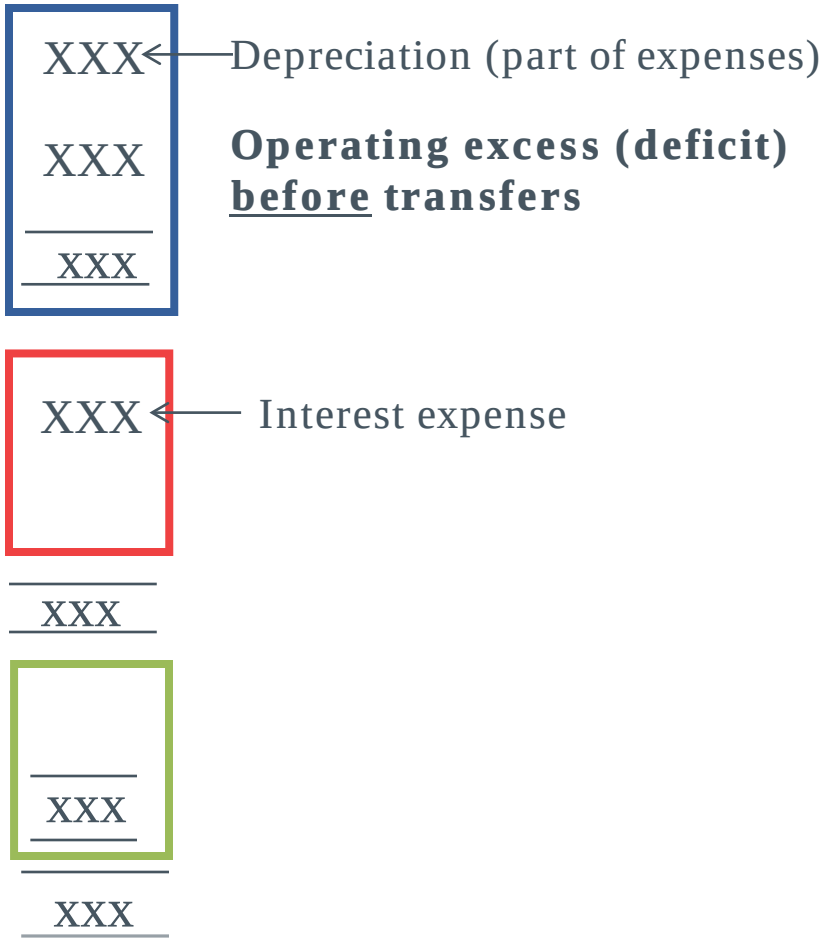
Statement of Activities – Depreciation and Interest

Without Donor Restrictions— Operating (Charitable and Business)

Without Donor Restrictions— Nonoperating

With Donor Restrictions



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Reporting of Expenses

Expense by nature and function → one place in the F/S

(statement of activities, separate statement, or schedule in notes)

FUNCTION

Not-functionalized

NATURE

	Program Activities		Supporting Activities		Total Operating Expenses	Non-Operating	Total Expenses
	Program A	Program B	M&G	Fundraising			
Salaries & Benefits							
Grants to Others							
Equipment Rental & Maintenance							
Occupancy Cost							
Depreciation							
Information Technology							
Professional Service Fees							
Supplies							
Travel							
Printing & Publication							
Interest							
Other							
Total							

*Either nature or function (or both) on face of Statement of Activities

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Reporting of Investment Returns

How to present?

- **Net presentation** of investment expenses against investment return on the face of the statement of activities
  - Netting limited to external and direct internal expenses

What to disclose?

- Disclosure of investment expenses **no longer required, except for** the disclosure of the amount of internal salaries and benefits that have been netted (if any) against investment return
- No longer require disclosure of investment income **components**

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Cash Flow Statement

- Require **Direct Method** for operating cash flows
  - No longer require Indirect Method
    - *Should indirect method still be required for certain NFPs?*
- **Re-categorize** certain items to better align operating cash flows with the operating measures
  - Purchases of and proceeds on sale of long-lived assets (e.g., PP&E; capitalized and noncapitalized collections)
  - Cash gifts restricted for long-lived assets
  - Cash from interest and dividends
  - Interest paid on long-term debt

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Cash Flow Statement

Cash Flows from Operating Activities	
Cash received from service recipients	
Cash received from donors	
Cash paid to employees	
Cash paid to vendors	
Purchase of property and equipment	
Proceeds on sale of property and equipment	
Contributions restricted for property and equipment	
Net cash from operating activities	
Cash Flows from Investing Activities	
Cash received from interest and dividends	
Purchase of investment assets	
Proceeds from sale of investments	
Net cash from investing activities	
Cash Flows from Financing Activities	
Payments of principal on long-term debt	
Interest paid on long-term debt	
Contributions restricted for endowment	
Net cash from financing activities	
Net increase in cash	
Cash at the beginning of year	
Cash at end of year	

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Project Timeline

Exposure Draft released for Public Comment

Apr. 2015

Apr. 2015 – Aug. 2015

Stakeholder Outreach/Speaking Engagements

Comment Period Ends

Aug. 2015 (120 days from Issuance)

Sep. 2015 – Oct. 2015

Public Roundtables

Begin Board Redeliberations

Oct. 2015

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Questions?

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Appendix

One Statement Approach

Statement of Activities

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

(a)(b) Amounts and purposes of aggregated transfers that are presented on the face would be disclosed in the notes to the financial statements.

Operating Nonoperating w/o donor restrictions; With donor restrictions

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Two Statement Approach

Statement of Operations

OPERATING ACTIVITIES		
Revenue and Support:		
Fees for services	$ 495	
Bequests	600	
Other contributions	425	
Restricted support released	1,375	
Total revenue and support	2,895	
Expenses:		
Total expenses	1,950	
Operating excess before transfers	945	
Transfers (to)/from operating activities:		
Aggregate of transfers to operating activities	150	a
Aggregate of transfers from operating activities	(500)	b
	(350)	
Operating excess after transfers	**$ 595**	

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Two Statement Approach (cont'd)

Statement of Changes in Net Assets

	Without Donor Restrictions		With Donor Restrictions	Total
Operating excess after transfers	$ 595	c		$ 595
NONOPERATING ACTIVITIES				
Contributions			1,500	1,500
Restricted support released			(1,375)	(1,375)
Interest expense	(75)			(75)
Investment return, net	170		445	615
Transfers (to)/from operating activities:				
Aggregate of transfers to operating activities	(150)	a		(150)
Aggregate of transfers from operating activities	500	b		500
	350			
Changes in Net Assets	**1,040**		**570**	**1,610**
Net assets at the beginning of the period	**1,500**		**2,100**	**3,600**
Net assets at the end of the period	**$ 2,540**		**$ 2,670**	**$ 5,210**

Operating Nonoperating w/o donor restrictions; With donor restrictions

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