FASB’s Proposed Changes to Not-for-Profit Reporting
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Introduction

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This e-book will cover topics contained in the financial statement exposure draft regarding FASB’s proposed changes to Not-for-Profit Reporting.

If after reading this eBook, you would like more information or have questions regarding FASB’s proposed changes, please visit kahnlitwin.com or contact us at trustedadvisors@kahnlitwin.com.
Part 1.

FASB’s Proposed Changes to NFP Reporting will Benefit Stakeholders

FASB has suggested several proposals in their latest exposure draft to improve Not-for-Profit financial statements and their effect on donors, creditors, and stakeholders.

Due to stakeholder critiques and the recent financial crisis, FASB decided that a comprehensive update to the current not-for-profit reporting model would be beneficial to donors, creditors and other stakeholders.

FASB expects that the proposed changes to Generally Accepted Accounting Principles (GAAP) will improve a stakeholder’s ability to assess an organization’s liquidity, cash flows, and general financial performance. Once the exposure draft is approved, organizations may have to implement many changes in their current accounting practices.
Benefits for Stakeholders

FASB’s proposed changes will improve current reporting requirements by giving stakeholders the ability to:

1. **Assess an organization's liquidity** - Since current practices do not really explain how restrictions affect liquidity, the proposed changes will enhance disclosures of an organization’s net assets and their availability in the near term.

2. **Assess an organization's financial performance** - FASB proposed a new requirement to report two intermediate measures which will reflect the results of current operations. (1) One measure would reflect the operating results before internal transfers and (2) the second measure would reflect the operating results following internal transfers that affect the availability of resources for current operations.
Assess an organization's sources and cash usage- In the past, a nonprofit's cash flow statement was generally the least used of the core financial statements, so the proposed changes will make the CFS more user friendly, specifically changing the presentation to include the direct method for the operating activities section of the CFS and increase understandability of a nonprofit's sources and cash usage.

Assess an organization based on management commentary- Similar to a Management Discussion and Analysis (MDA), this proposed change from FASB's Not-for-Profit Advisory Committee (NAC) would use management commentary to assist in explaining the financial status of an organization. Most stakeholders acknowledge that analyzing an organization solely through financial statements has its limits.
Part 2.

New FASB NFP Regulations: Changes to Net Reporting

Organizations will want to keep abreast of how these proposed changes will affect Net Assets.

Significant changes and clarifications to the Net Assets section of an organization's financial statements are being proposed.

In changing certain terminology, the FASB hopes that organizations can improve their communication to creditors, donors, and other stakeholders about the practicality and comprehensibility of their financial statements.
Changes to Net Asset Reporting

The FASB has proposed a number of key changes affecting the way organizations will report net assets, including:

**Single donor restricted class of net assets** - The FASB has not made changes to net asset reporting since FASB 116 and 117 were implemented in 1994. Within the last few years, nearly all states have adopted a version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), but the FASB still thinks the line between temporary and permanent restrictions is confusing.

By instituting regulations for more clear disclosures about various types of restrictions provided in the notes to the financial statements, the FASB hopes to prevent the loss of useful information, reduce complexity, and increase understandability of net asset information in financial statements.
The FASB proposes collapsing the restricted net asset classes into one designation, which would be labeled “net assets with restrictions”, and will discourage the use of the terms “temporarily restricted” and “permanently restricted”.

Changing term “unrestricted net assets” to “net assets without donor restrictions”- The term “unrestricted net assets” is sometimes misconstrued to mean without any restrictions, according to the FASB, hence the change in terminology.

With this proposed change, the FASB hopes to better demonstrate that net assets which are not subject to donor-imposed restrictions could be subject to other restrictions under laws, regulations, and terms and conditions of bond agreements and other contracts.
Re-classifying the amount by which a donor restricted endowment fund are “underwater” - “Underwater” endowment funds have current market values that have declined below their original values. Currently the underwater amount of the fund is reported within unrestricted net assets or as net assets without donor restrictions. The FASB has proposed that the entire amount of the fund should be reported as permanently restricted or as net assets with donor restrictions.

Laws before UPMIFA stated that spending from an underwater endowment fund was prohibited until the fund was restored to its historic dollar value (HDV). The FASB believes that it is consistent with current laws to classify the entire amount of an endowment fund as donor restricted, whether it is underwater or not.

By not dividing an endowment fund into two separately classified amounts, creditors, donors, and other stakeholders can better understand the information and find it more useful than before.
Part 3.

New FASB NFP Regulations: Changes to Statement of Activities

The FASB hopes to better reflect financial status and performance in the statement of activities by making clear that:

- Operating revenues include all revenues that were garnered from carrying out an NFP’s mission and are available for current-period activities. All expenses resulting from carrying out those activities qualify as operating expenses.

- Donor restricted contributions to support specified operating activities do not qualify as current-period operating revenues.

- Revenues and expenses from (or for) investing and financing would not qualify as operating revenues (or expenses) because those activities are not typically from or directed at carrying out an organization’s mission.
Changes to Statement of Activities

Better communication on how resources are being managed is FASB's aim behind the following proposed changes:

**Requirement that organizations must present details on governing board actions (internal transfers) that affect the availability of resources for current-period operations.** FASB has proposed a rule that would require organizations to report two intermediate measures of operations in order to be more transparent:

1. an operating excess/deficit before transfers and
2. an operating excess/deficit after transfers.

This would allow users of the organization's financial statement to better understand those revenue and expenses that relate to the actual mission for which an NFP exists vs those resources that are not from or directed at carrying out an NFP's purpose for existence.
Requirement that all not-for-profit organizations (not just voluntary health and welfare NFPs) disclose in one location (on the actual statement of activities or in the notes to the financial statements) information about the function and nature of operating expenses.

This would help creditors, donors, grantors, etc. the ability to assess the degree to which operating expenses are fixed or discretionary, how much goes towards the NFP’s programs, and the costs of the NFP provided services.

Currently GAAP requires all NFP’s to disclose the three functional expense categories (program, general and administrative, and fundraising) but only voluntary health and welfare organizations are required to disclose the natural classifications.
New FASB NFP Regulations: Changes to Statement of Cash Flows

The statement of cash flows is used to assess business performance and cash flow trends that affect liquidity. The FASB is proposing to update the nonprofit statement of cash flows in the following ways:

- Requiring organizations to use the direct method of reporting for the “operating activities section” on the statement of cash flows.
- Re-classifying cash flows to better align with operating activities.

Let's take a closer look at the changes and updates on reporting requirements FASB is making in efforts to increase their versatility.
Changes to Statement of Cash Flows

Requiring organizations to use the direct method of reporting for the “operating activities section” on the statement of cash flows.

The FASB has proposed to no longer require organizations to report operating cash flows using the indirect method. Stakeholders expressed concern at the complexity and frequent irrelevance of the indirect method so the board saw a need for change.

The FASB prefers the direct method, which is prepared using the direct transaction amounts that alter the nonprofit’s cash account. It has been shown to provide the best basis to forecast cash flows and potential earnings. Though the direct method has proven to be more expensive to implement, organizations have found that the increased cost is justified when they look at how much more understandable and useful the information is as compared to the indirect method. Under the proposal, organizations will have the option of providing operating cash flows using the indirect method, in addition to the direct method disclosures.
Changes to Statement of Cash Flows

Re-classifying cash flows to better align with operating activities.

Board members have said that classifying cash flows in ways that are better aligned with the change in operating activities proposed for the statement of activities will increase the clarity of statements and comparability among other NFPs.
Comment Period

A nonprofit’s financial statements are a key part of a donor’s decision to trust the organization, so these changes are expected to improve the usefulness and understandability of financial information. The comment period was open to all stakeholders on all matters in the proposed update.

All comments were due August 20th.
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