How ASU 2016-14 Will Affect Your Not-for-Profit Entities

Part I: Liquidity and Expense Allocation

Today’s Presenters

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Learning Objectives

ASU 2016-14 Presentation of Financial Statements of Not-for-Profit Entities

- Liquidity
- Expense Allocation

Polling Question #1

How ready is our organization to implement ASU 2016-14?

A. Very ready: we have already implemented

B. Somewhat ready: we have plans in place to implement

C. We will get there: still trying to figure out the real impact to our organization

D. Not sure: What is ASU 2016-14

Recap of ASU 2016-14

Polling Question #2

When is ASU 2016-14 effective?

A. Calendar year 2017 or fiscal year 2018

B. Calendar year 2018 or fiscal year 2019

C. Calendar year 2019 or fiscal year 2020

D. Calendar year 2020 or fiscal year 2021

Timeline for Adoption

- Effective for financial statements for fiscal years beginning **after December 15, 2017** (i.e. calendar YE ‘18 and fiscal YE ’19)
- **Early adoption is permitted**, subject to the designated transition method

WHAT IS IT?

- Update, **not** overhaul
- Significant changes
- Updates to **all three** financial statement types

Goals And Objectives

- Improve net asset classification
- Improve information in financial statements and notes:
  - Financial performance
  - Cash Flow
  - Liquidity
- Better enable NFPs to tell their financial story
- Better serve the needs of financial statement users
- Create clarity, uniformity and comparability in reporting across the financial statements of various NFPs
- Provide donors and lenders with liquidity information to better assess the financial health of the NFPs

Summary of the Changes

- New liquidity and availability disclosures required
- Net asset classes reduced from three to two
- Additional disclosures for underwater endowments
- All not-for-profits (NFPs) must report expenses by nature and function in one place, and describe the methods used to allocate among functional categories

Summary of the Changes

- Net investment return replaces other alternatives

- Use of direct method in a statement of cash flows eliminates reconciliation of change in net assets to cash flows from (used for) operating activities

Learning Objectives

Changes to Liquidity and Availability

ASU 2016-14
Liquidity

- Reasons for change:
  - Make it easier for readers of the financial statements to **assess the organization's liquidity** and to determine the availability of restricted resources to **fund general expenditures**
  - Added **transparency**

NFP Financial Statements Project

Liquidity

Current GAAP: There is no requirement to disclose information about liquidity, although statement of financial position must be presented in order of liquidity.

FASB took a deep look into liquidity and availability of funds:

- **Liquidity:** Relates to the type of assets the Organization has and the maturity of those assets to meet current obligations.
- **Availability:** Is it available for use? Are there donor imposed other external restrictions? Or even self-imposed limits?

NFP Financial Statements Project

Liquidity

The FASB Board decided that an entity needs to disclose how it manages its liquidity and availability.

Your organizations financial statements will now need to disclose the following:

A. Quantitative information: All about the numbers

B. Qualitative information: All about the words

Steps to Take

Liquidity

- ► Determine the format to present the required quantitative disclosure of liquidity information

- ► Gather information for quantitative footnote requirements.
  - » Assess how they manage their liquid
  - » Evaluate all organization financial assets (this can get tricky)

First Steps to Take

Liquidity

Gather information for qualitative footnote requirements.

- Identify all financial assets
- Policy for managing liquidity

Polling Question #3

Do you think your users of the financial statements will get any benefit from this new disclosure?

A. Yes, from the Qualitative portion

B. Yes, from the Quantitative portion

C. Yes, from A & B

D. No, I don’t think it will help

Polling Question #3

Do you think your users of the financial statements will get any benefit from this new disclosure?

► Poll Results

EXAMPLE FOOTNOTE A

Quantitative: NFP A has $395,000 of financial assets available within 1 year of the balance sheet date to meet cash needs for general expenditure consisting of cash of $75,000, contributions receivable of $20,000, and short-term investments of $300,000. 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.

Qualitative: NFP A has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately $275,000. NFP A has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, NFP A invests cash in excess of daily requirements in various short-term investments, including certificate of deposits and short-term treasury instruments. As more fully described in Note XX, NFP A also has committed lines of credit in the amount of $20,000, which it could draw upon in the event of an unanticipated liquidity need.

EXAMPLE FOOTNOTE B

NFP A's financial assets available within one year of the balance sheet date for general expenditure are as follows.

Cash and cash equivalents	$	4,575
Accounts and interest receivable		2,130
Contributions receivable		1,825
Short-term investments		1,400
Other investments appropriated for current use		1,650
	$	11,580

NFP A's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. As described in Note Y, the quasi-endowment has a spending rate of 5 percent. $1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.

As part of NFP A'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, NFP A invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of $20 million, which it could draw upon. Additionally, NFP A has a quasi-endowment of $33 million. Although NFP A does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, amounts from its quasi-endowment could be made available if necessary).

EXAMPLE FOOTNOTE C

Note G

The following reflects Not-for-Profit Entity A's 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 quasi-endowment.

EXAMPLE FOOTNOTE C

Qualitative Example

Financial assets, at year end	$500,000
Less those unavailable for general expenditures within one year, due to:	
Contractual and donor-imposed restriction:	
Donor restricted for time or purpose	($125,000)
Investments held in trust	($75,000)
Contractual limited assets (held in trust)	($50,000)
Board designated endowment funds used primarily for long term investing	($125,000)
Amounts set aside for liquidity reserves	($25,000)
Financial assets available within one year to meet cash needs for general expenditures within one year	$100,000

NFP Financial Statements Project

Liquidity

How to Identify all financial assets and any limitations on availability for expenditure in the next 12 months

Gross amount of assets from the SOP – amounts unavailable for general expenditures = amounts available to meet the organization’s cash needs in the next 12 months

Items to Think About:

- Cash
- Cash Restricted
- Investments
- Accounts Receivable
- Contributions Receivable
- Split-interest agreements
- Beneficial agreements
- Endowment assets

Items to Exclude:

- Fixed Assets
- Prepaids
- Inventory
- Other illiquid assets
- Board-designated funds
- Assets with restrictions
- Donor-advised funds

Polling Question #4

Which of the following items should NOT be included in the available to meet obligations?

A. Split interest agreements

B. Endowment assets

C. Contributions Receivable

D. Board-designated funds

Polling Question #4

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A. Split interest agreements

B. Endowment assets

C. Contributions Receivable

D. **Board-designated funds**

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Examples of limitations that may make financial assets **unavailable**		
Its nature	Financial assets not convertible to cash within next 12 months	Contribution receivables due > 1 year
		Accounts/Notes receivable due > 1 year
		Illiquid investments not redeemable within 1 year
External limits of donors, laws, contracts	Donor restrictions limiting availability	Endowment financial assets considered perpetually restricted
		Assets from unappropriated endowment earnings, beyond 1 year
		Restricted for programs in future years, beyond 1 year
		Trusts and life income funds
	Contracts or legal restrictions	Bond sinking funds
		State required annuity reserves
Internal limits imposed by governing board decisions	Financial assets designated for long-term investing	Quasi-endowments intended for long-term investment
		Annuity funds
		Donor advised funds
	Intended for future years	Designated to future construction or deferred maintenance expected beyond 1 year (or all assets intended for long-lived assets???)

Feedback Received: Liquidity

- **Mixed** feedback for disclosures of information about liquidity
  - » More support for qualitative disclosures than quantitative disclosures
  - » Some who disagree express concern that:
    - Information will be outdated by time financial statements are issued
    - Business entities not required to provide information proposed for NFPs
    - Extensive disclosures reduce usefulness, and many users don’t read notes
    - Disclosures too subjective, would result in inconsistent approaches among NFPs, reducing comparability

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Client To-Do List

- Identify a champion
- Review ASU 2016-14
- Training to accounting staff
- Review systems in place
- Start thinking about information needed
- Communicate

Learning Objectives

**Changes to
Expense Reporting**

Expense Reporting

- Reasons for change:
  - Increase understandability and usefulness
  - Increase comparability across nonprofits
  - Added transparency

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Expense Reporting

New Standard:

All nonprofits are now required to present expenses by both NATURE (salaries, rent, travel) and FUNCTION (program and supporting)

Expense Reporting

Current GAAP

Schedule of functional expenses mandatory for health and welfare organizations and recommended, but not required, for other NFPs.

New GAAP

Expenses reported by nature and function either in statement of activities, schedule of functional expenses or in notes for **all** NFPs.

This shall be presented in an analysis that disaggregates **functional expense classifications** by their **natural expense classifications**.

Expense Reporting

Analysis of operating expenses by nature **and** **function → one place in the F/S** (statement of activities, separate statement, or schedule in notes), with additional qualitative information about cost allocations

Functionalization is optional

FUNCTION

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**

Expense Reporting

	Program Activities				Supporting Activities			
	A	B	C	Programs	Management & General	Fund-Raising	Supporting	Total Expenses
Salaries & Benefits	$ 7,400	$ 3,900	$ 1,725	$ 13,025	$ 1,130	$ 960	$ 2,090	$ 15,115
Grants to Other Orgs	2,075	750	1,925	4,750				4,750
Supplies & Travel	865	1,000	490	2,355	240	560	800	3,155
Services & Professional Fees	160	1,490	600	2,250	200	390	590	2,840
Office & Occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,140	800	570	2,810	250	140	390	3,200
Interest	171	96	68	335	27	20	47	382
Total Expenses	$ 13,296	$ 8,649	$ 5,873	$ 27,782	$ 2,038	$ 2,150	$ 4,188	$ 31,970

Expense Reporting

Functional expense classifications:

Program services: Activities that result in goods and services being distributed to beneficiaries, customers or members that fulfill the purposes or mission for which a nonprofit exists

Functional expense classifications:

Supporting services: Supporting activities are all activities of a NFP other than program services. Generally, supporting activities include the following activities:

- Management and general activities
- Fundraising activities
- Membership Development activities

Expense Reporting

Supporting services:
Management and general activities

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than **contributions** and membership dues contracts, including billing and collecting fees.

Expense Reporting

Supporting services:
Management and general activities

- Disseminating information to inform the public of the NFP's stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report
- Employee benefits management and oversight (human resources)
- All other management and administration except for direct conduct of program services, fundraising activities, or membership development activities.

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Expense Reporting

- Cost allocations
  - Certain costs benefit more than one function and, thus, should be allocated

  - Joint Costs – the ASU does not change requirements for the allocation, reporting, and disclosure of joint costs

Example: Cost allocations - CEO

At Not-for-Profit Fluffy Puppy, the chief executive officer spends a portion of time:

- Directly overseeing the rescue program
- Working with current and potential donors on fundraising activities
- Supervising the other areas of Fluffy Puppy

How should you allocate the CEO's compensation?

A. Programs
B. Management and general
C. Fundraising
D. Allocated to A & C
E. Allocated to A, B, C

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Expense Reporting

Example: Cost allocations - CFO

At Not-for-Profit Fluffy Puppy, the CFO has primary responsibility for

- accounting and reporting
- short-term budgeting and long-term financial planning
- cash management
- direct oversight of Fluffy Puppy's endowment.

How should you allocate the CFO's compensation?

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B. Management and general
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Expense Reporting

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Expense Reporting

Example: Cost allocations - Human Resources

The human resources department at Fluffy Puppy generally is involved in the benefits administration for all personnel of Fluffy Puppy. This includes:

- All of management
- All employees that are allocated to program activities
- All fundraising employees

How should you allocate the Human Resources expenses?

A. Programs
B. Management and general
C. Fundraising
D. Allocated to A & B
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Expense Reporting

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Expense Reporting

Example: Cost allocations –
Grant Accounting and Reporting

Fluffy Puppy receives federal grants and employs an accountant who is responsible for grant accounting and reporting. In some cases, under the terms of the grant agreement, a fiscal report is required to be filed that details expenses incurred and charged against the grant.

How should you allocate the Grant Accounting expenses?

A. Programs
B. Management and general
C. Fundraising
D. Allocated to A & B
E. Allocated to A, B, C

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Expense Reporting

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B. Management and general
C. Fundraising
D. Allocated to A & B
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SAMPLE UPDATED DISCLOSURE

Note X1: Methods Used for Allocation of Expenses from Management and General Activities

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is allocated based on square footage, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

Feedback Received: Reporting of Expenses

- Overall **support** for all NFPs to report analysis of operating expenses by both function and nature in single location
- Suggest it aids in user understanding and comparability across industries
- Some who disagree:
  - Express concern with lack of consistency between Form 990 and proposed GAAP analysis
  - Prefer that reporting of expenses by both function and nature remain optional

Expense Reporting

Client Implementation:

- Clients should review the clarifications in the ASU regarding expense allocations
- Need to decide how that information will be presented and disclosed
- Revisit chart of accounts and appropriateness
- Establish top-side reallocation approach for indirect or shared expenses for functional presentation
  - Depreciation, interest, salaries, facilities

Questions?

Thank You for Your Time!

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