FASB Proposes Significant Changes to NFP Financial Reporting

On April 22, 2015, the Financial Accounting Standards Board (FASB) proposed significant changes to not-for-profit financial reporting. The proposed Accounting Standards Update (ASU), Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities, would change several requirements for financial statements and notes of all not-for-profit (NFP) entities, as well as certain requirements specific to health care entities. The changes are worthy of attention, and FASB encourages NFPs and vested stakeholders to review and comment on the proposal by August 20, 2015.

The proposed standards would represent the most significant changes in NFP reporting rules since 1993, when FASB issued Statement No. 116 and Statement No. 117. FASB proposes significant changes to the fundamental reporting model, with the intent of providing intuitive financial and liquidity information to donors, grantors, lenders and other users of NFP financial statements:

- The NFP statement of financial position would distinguish between two new classes of net assets—those with donor-imposed restrictions and those without—replacing the existing three classes of net assets. The proposal retains the current requirements to provide information on the nature and amount of different types of donor restrictions in the notes to the financial statements.

- The statement of activities would include a new standardized operating measure, requiring NFPs to classify all revenues and expenses as an operating or nonoperating activity. Within the operating activities associated with changes in net assets without donor restrictions, the statement would include two new measures of operating performance presented as subtotals before and after internal transfers. The first subtotal would present operating activities before internal transfers and without donor-imposed restrictions. The second subtotal would include self-imposed limitations that mark otherwise currently available amounts as unavailable, and vice versa, in a way that discloses resources available for use in the current period. The “performance indicator” currently required of business-oriented health care NFPs no longer would be required, but would be optional.

- The proposal would require NFPs to report expenses by both nature and function, either on the face of the statement of activities, as a separate statement or within the notes. Voluntary health and welfare organizations no longer would be required to provide a statement of functional expenses; they instead would have the presentation options available to all NFPs.

- The proposal requires NFPs to use the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset. This eliminates the option to release the donor-imposed restriction over the estimated useful life of the acquired asset.

- An NFP would report investment income net of external and direct internal investment expenses on the statement of activities; it no longer would be required to disclose the amount of investment expenses netted against investment returns, other than the amount of internal direct costs of salaries and benefits.

- Regarding the statement of cash flows, not-for-profits will be required to use the direct method versus the indirect method, providing increased congruency with the redesigned statement of activities. The change is likely to affect higher education financial statement users, generally accustomed to seeing the indirect method. In addition, FASB proposes reclassifying items reported in a cash flow statement to better align them with the ASU’s proposed notion that operating activities reporting in the statement of activities should be based on whether “resource inflows and outflows are from or directed at carrying out an NFP’s purpose for existence.”
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- FASB proposes new and enhanced quantitative and qualitative disclosures to provide additional information useful in assessing liquidity and cash flows, including a description of the time horizon used to manage its liquidity, and near-term availability and demands for cash as of the reporting date.

The proposed amendments would be applied on a retrospective basis. FASB will determine the effective date and whether it should be the same for all not-for-profit entities, as well as whether early adoption would be permitted, after considering stakeholder feedback. The comment period ends 120 days from issuance of the exposure draft.

For more information on this topic, contact your BKD advisor.

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