Feedback on FASB Proposal to Change NFP Financial Statement Presentation

The Financial Accounting Standards Board’s (FASB) April 2015 proposed accounting standards update (ASU), *Presentation of Financial Statements of Not-for-Profit Entities*, would result in significant changes to the current NFP reporting model—and FASB has received considerable feedback. Overall, users and preparers appreciated FASB’s efforts to provide intuitive financial position, financial performance and liquidity information to users, but a majority of the feedback was mixed. This paper summarizes FASB’s presentation to the Not-for-Profit Advisory Committee (NAC) on September 10 - 11, 2015, on outreach feedback, which includes comment letters and workshops. The complete presentation and handouts are accessible through the FASB website.

Background

FASB issued the proposed amendments with the following key objectives:

- Update, not overhaul, the current NFP reporting model
- Improve net asset classification
- Improve information in the financial statements and notes about statement of financial position and liquidity, statement of activities (including financial performance) and statement of cash flows (including financial performance)
- Better enable not-for-profits to tell their financial story

FASB proposed to change presentation and disclosure requirements in five key areas, as listed below in Exhibit A. A large focus of the project is to enhance consistency and transparency in operating performance reporting for all not-for-profits (NFP). Many presentation and disclosure amendments address the current diversity in practice around reporting of transactions as operating, recurring or nonrecurring items, which can hinder a user’s ability to compare NFPs.
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Exhibit A – Key Areas of Proposed Change

- **Improve Net Asset Classification Scheme**
  - Combining temporarily and permanently restricted net asset classes

- **Statement of Financial Position & Liquidity Information**
  - Disclosures of qualitative and quantitative liquidity information
  - Classifying underwater endowment funds within net assets with donor restrictions rather than unrestricted net assets
  - Disclosure of the NFP’s policy on spending from underwater endowment funds together with the aggregated original gift amount required to be maintained by the donor or by law

- **Statement of Activities, Including Financial Performance**
  - All NFPs to report an analysis of operating expenses by function and nature in a single location
  - Reporting investment income net of external and direct internal investment expense
  - Reporting of expirations of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets using the placed-in-service approach
  - Disclosure of internal salaries and benefits netted against investment return; disclosure of all investment expenses is unnecessary
  - Presentation of all internal transfers on the face of the statement of activities
  - Consider as operating revenue/support unrestricted gifts of long-lived assets when received, or restricted gifts for long-lived assets when placed in service, then present them as a transfer from operating to nonoperating activities
  - Requirement to present intermediate measures of operations
  - Requirement to classify interest expense and fees and related expenses incurred as financing activities and not as operating activities

- **Statement of Cash Flows, Including Financial Performance**
  - Closely aligning operating items on the statement of activities to the statement of cash flows
  - Requiring the direct method of statement of cash flows

- **Business-Oriented Health Care Entities**
  - No requirement for business-oriented health care NFPs to present classified balance sheet
  - No requirement for business-oriented health care NFPs to report their performance indicator
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Feedback

When FASB presented the report to the NAC, FASB received 263 comment letters—about half from preparers and a third from auditors. Exhibit B summarizes the type of respondents from which FASB received comment letters.

Exhibit B – Feedback by Respondent Type

As part of its due process to gather feedback and discuss more in-depth the reasoning behind the feedback provided by comment letters, FASB led workshops and roundtable discussions. In addition, the board recently hosted three public roundtable discussions to give those that submitted a comment letter a chance to discuss the proposals with board members.

Feedback Summary

Based on FASB’s presentation to the NAC, respondents overall expressed support of the Board’s objective to update the current NFP reporting model. Other common themes from the comment letter and roundtable discussions include:

- Desire to maintain as much consistency as possible between NFP and for-profit financial reporting
- Desire for a proposal that better takes into consideration NFP entity differences
- Concern regarding the potential costs of implementing the proposal

Based on the feedback received, comparability between NFP industries and for-profit industries is more important than comparability between dissimilar NFPs, especially for more “business-like” NFPs such as health care entities; many financial statement users have a for-profit background and better understand for-profit financial statements.

FASB has identified 16 key feedback items. The chart below categorizes this feedback amongst the five areas of proposed changes, based on whether FASB has received overall support for the change, overall disagreement or a mixed feedback. The feedback is color-coded to correspond with the areas of proposed changes in Exhibit A.
### Exhibit C – Summary of Proposal Feedback

<table>
<thead>
<tr>
<th>Overall Support</th>
<th>Overall Disagreement</th>
<th>Mixed Feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combining temporarily and permanently restricted net asset classes</td>
<td>Disclosure of internal salaries and benefits that are netted against investment return, while disclosure of all investment expenses is unnecessary</td>
<td>Disclosures of qualitative and quantitative liquidity information</td>
</tr>
<tr>
<td>Disclosure of the NFP’s policy on spending underwater endowment funds along with the original gift amount</td>
<td>Present all internal transfers on the face of the statement of activities</td>
<td>Required intermediate measures of operations</td>
</tr>
<tr>
<td>Classifying underwater endowment funds within net assets with donor restrictions</td>
<td>Interest expense and fees and related expenses incurred are not directed at carrying out and NFP’s purpose and, thus, should not be classified as operating activities</td>
<td>Requiring the direct method of statement of cash flows</td>
</tr>
<tr>
<td>All NFPs to report an analysis of operating expenses by both function and nature in a single location</td>
<td>Consider as operating revenue/support unrestricted gifts of long-lived assets when received, or restricted gifts for long-lived assets when placed in service, then present them as a transfer from operating</td>
<td></td>
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<tr>
<td>Reporting the expiration of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets using the placed-in-service approach</td>
<td>Aligning operating items on the statement of cash flows and statement of activities</td>
<td></td>
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<tr>
<td>Reporting investment income net of external and direct internal investment expense</td>
<td>Removal of the requirement for business-oriented health care NFPs to present a classified balance sheet</td>
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<tr>
<td></td>
<td>Removal of the requirement for business-oriented health care NFPs to also report their performance indicator if intermediate measures of operations are required</td>
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</table>
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Improve Net Asset Classification Scheme

Combining Temporarily & Permanently Restricted Net Assets

As expected, FASB received overall support for combining the two classes of net assets. Many who disagreed argued permanent restrictions are fundamentally different from temporary restrictions and users may not read or understand the notes disclosing the purpose and use of donor restrictions.

Statement of Financial Position & Liquidity Information

Underwater Endowments

FASB received overall support for classifying underwater endowment funds within net assets with donor restrictions rather than net assets without donor restrictions.

Spending from Underwater Endowment Funds

Respondents generally support the disclosure of the NFP’s policy on spending from underwater endowment funds together with the aggregated original gift amount that is required to be maintained by the donor or by law.

Disclosures of Information about Liquidity

FASB received mixed feedback on the proposed disclosures of liquidity information. Respondents expressed more support for the qualitative disclosures than the quantitative disclosures, citing concerns over a vague “time horizon” concept, subjectivity of the disclosures and usefulness of the disclosures by the time NFPs issue their financial statements. Common suggested alternatives include requiring a classified balance sheet as an alternative to additional disclosures and requiring separate presentation on the balance sheet of assets for which use is limited.

Statement of Activities, Including Financial Performance

Intermediate Measures of Operations

FASB received mixed feedback on required intermediate measures of operations. According to FASB’s report to the NAC, many agree with requiring intermediate measures of operations but disagree with the intermediate measures proposed. Some respondents expressed a desire for a clarified definition, flexibility in defining operations and a single measure of operations instead of two. Many who disagreed said differentiating activities between operating and nonoperating would not increase comparability due to the significant differences in operating activities among the various types of NFPs, among other concerns.

Business-oriented health care entities are particularly concerned with the new metrics. FASB proposes business-oriented health care NFPs replace their performance indicator with the proposed intermediate measures of operations; it also would remove the requirement that they present a classified balance sheet if the proposed liquidity disclosures are adopted.

Internal Transfers

Respondents disagreed with presenting all internal transfers on the face of the statement of activities. They expressed concern over management manipulation, complexity and inappropriateness of including the impact of internal events in operating results. Some respondents suggested segregating program activities from contributions and investing activities and including a roll-forward of internal transfers in the note disclosures.

Gifts of, or for, Property, Plant & Equipment

Respondents support the requirement to report expirations of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets using the placed-in-service approach. However, overall they
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disagree with reporting unrestricted gifts of long-lived assets as operating revenue/support when received or placed in service for restricted gifts and then presenting them as a transfer from operating to nonoperating activities. Many respondents said they would prefer such gifts be recorded directly in nonoperating income, citing concerns over volatility and conceptual presentation differences or overall disagreement with the transfer model.

Interest Expense

Overall, the majority of respondents did not agree with FASB’s position that interest expense—and fees and related expenses incurred—is not directed at carrying out an NFP’s purpose and, thus, should be classified as financing activities rather than operating activities. Respondents who disagreed expressed concerns including the restrictive nature of the rule and reduced comparability with for-profit reporting, and some provided their own suggestions for presenting interest expense.

Investment Income & Expense, Net

FASB received overall support for all NFPs to report investment income net of external and direct internal investment expense.

Respondents overall disagreed with eliminating the requirement to disclose all investment expenses while requiring disclosure of internal salaries and benefits the organization nets against investment return. Most respondents believed (or thought) disclosure of all investment expenses is unnecessary, including internal salaries and benefits.

Expenses by Function & Nature

Respondents expressed support for all NFPs to report an analysis of operating expenses by both their function and nature in a single category (generally in the notes), saying the information aids in user understanding and comparability across industries. Those who disagreed cited cost concerns and lack of consistency between Form 990 and proposed generally accepted accounting principles functional expense reporting. Some requested that the reporting remain optional.

Statement of Cash Flows, Including Financial Performance

Direct Method

FASB received mixed feedback on requiring the direct method of presenting operating cash flows. Most respondents acknowledged the direct method is more understandable than the indirect method, but opposition occurred for several reasons: For-profits are not required to use the direct method, implementation costs and general disuse of the statement of cash flows. Many believed no necessary information would be lost if the indirect method is no longer required, but respondents prefer to retain the reconciliation of operating cash flow to total change in net assets.

Alignment of Operating Items on the Statement of Cash Flows & Statement of Activities

Overall, respondents disagreed with aligning certain items presented in the statement of cash flows with the proposed operating classification in the statement of activities. FASB believed this would increase understandability even though the proposed reporting would be somewhat different from current requirements for business entities. Most who disagree expressed a preference for current requirements to remain the same until requirements change for business entities—citing the overall desire to maintain as much consistency as possible between NFP and for-profit entity financial statements. Of particular concern is the classification of cash gifts received/payments related to long-lived assets from financing or investing activities to operating activities.
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Business-Oriented Health Care Entities

Most respondents disagreed with FASB’s proposals to remove the requirement for business-oriented health care NFPs to present a classified balance sheet and to report their performance indicator.

According to FASB’s presentation, most who disagreed were concerned with the loss of comparability with for-profit health care entities who present classified balance sheets or the industry performance indicator. Some would prefer a requirement to sequence assets and liabilities according to nearness to cash, while others would prefer a requirement for a separate presentation of assets whose use is limited. Most who agreed with both proposals support the increased consistency that would result among different types of NFPs.

Next Steps

FASB met in October 2015 to discuss the feedback received from comment letters, workshops and discussions and vote on a redeliberation plan. The board decided to divide its redeliberations into two separate workstreams. The first includes proposed changes not dependent on other projects and those for which FASB plans to complete redeliberations by June 30, 2016. This stream includes:

- Net asset classification scheme
- Expenses, including presenting expenses by nature and by function, netting of investment expenses against investment return and disclosures about cost allocations
- Disclosures about liquidity
- Statement of cash flows – direct versus indirect method of presenting operating cash flows
- Operating measures – improving disclosures by NFPs that choose to present such a measure

The second workstream No. 2 includes redeliberation of other proposed changes that involve consideration of alternatives suggested by stakeholders the board did not previously consider or are related to similar issues being addressed in other projects. FASB has not posted an estimated completion date for the second workstream, which includes:

- Statement of cash flows – realignment of certain line items
- Operating measures – all other elements of the proposal, including
  - Whether to require intermediate measures
  - How to define such measures and which items should or should not be included in the measure
  - Alternative disaggregation approaches suggested by stakeholders

As part of its redeliberations, FASB will evaluate the needs of donors, grantors, lenders and other NFP financial statement users against the costs of the proposed amendments. FASB hasn’t provided an estimated date for release of the final standard. BKD will continue following the NFP project and offering updates.

Before the roundtable discussions, FASB compiled a presentation outlining its findings and feedback received from the comment letters and workshops. This presentation provided the information for the rest of the report.

Related Resources

FASB Proposes Significant Changes to NFP Financial Reporting

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