Not-for-Profit Perspectives

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Changes Coming With FASB's NFP Reporting Project

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For a few years, commentary has been swirling related to perceived complexities and inconsistencies in reporting of not-for-profit financial statements. The discussion has focused on various topics ranging from functional expense allocations to the lack of understanding related to temporarily and permanently restricted net assets by readers of the financial statements. On March 4, 2015, FASB released the minutes from its most recent board meeting on this project. This article is a summary of the tentative decisions published in those minutes.

Expense Reporting

Many organizations utilize different titles or descriptions in describing their programs of their programs and supporting departments. The methodologies for allocating expenses across the defined programs are just as varied. The ability for each organization to justify its functional expense reporting under the current standards creates a situation in which comparability of organizations within an industry is very difficult. This project will attempt to combat the comparability issue by requiring all not-for-profits to include in its basic financial statements a statement of functional expenses. This statement will still allow management to include functional expense categories that are meaningful to the specific organization and the users of its financial statement, but will also require disclosure of the natural classification of expenses (salaries, benefits, occupancy, etc.). Many not-for-profits report their functional expenses on the face of the statement of activities to meet the current reporting requirement and opted not to present the natural classification in the financial statements. Only voluntary health and welfare organizations are currently required to present a statement of functional expenses.

In addition, the proposal suggests other changes to expense reporting:

- Investment expenses will be required to be netted against investment returns. The disclosure of the expenses would be permitted but not required.
- Unrelated business income taxes related to investments and/or excise taxes on investments are to be netted against investment returns. Disclosure of these items would be subject to the significance of the amount or percentage of the tax and management's determination of the interest of this information to the readers of the financial statements. (Continued on Page 2)

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Not-for-Profit Update

Changes Coming With FASB's NFP Reporting Project (continued)

Reporting and Definition of Operations

Under current standards, not-for-profits are required to adequately describe their mission, operations and programs. There is no requirement to differentiate operating vs. non-operating activities, but if they choose to separate these items in the statement of activities, the organization must also describe the methodology utilized to report transactions as operating or non-operating. The proposal includes a requirement for all organizations to differentiate revenues and expenses in the statement of activities between operating and non-operating activities based on their mission and availability of resources. The proposal also requires that resources restricted for the acquisition of "capital-like" items be released from restrictions within operations and subsequently transferred out of operations. Governing board decisions to designate, appropriate or transfer resources between operating and non-operating will be required to be presented in the aggregate either on the face of the statement of activities or in a footnote to the financial statements.

The minutes to the project meeting also discuss the misalignment of the definition of operations between the statement of activities and the statement of cash flows. Discussion on this topic included moving specific transactions, such as the sale of long-term assets, to the operating section in the cash flow statement to requiring the direct method of reporting in the statement of cash flows.

Net Asset Classification

As mentioned in previous articles, this project will look to reduce the number of net asset classes reported on the face of the financial statement from three to two. Rather than presenting totals for unrestricted, temporarily restricted and permanently restricted net assets, organizations will be required to only present totals for net assets with donor restrictions and without donor restrictions. Additional information will be required to be disclosed in the footnotes related to the organization's ability to use donor restricted net assets. "Underwater" donor restricted endowments will be reported in the donor restricted category instead of the current reporting in unrestricted.

Additional Items

The following items were also identified within the proposal:

- The presentation of "board designated" items would include designation decisions made by the governing board's designees, i.e. management.
- Certain items, including activity of collection items, write-off of goodwill upon acquisition and other equity transfers, will be presented separate from revenues, expenses, gains and losses within the operating activity section of the statement of activities.
- A requirement for new or increased disclosure of quantitative and qualitative information regarding liquidity.

The minutes state that these proposed changes are intended to reduce reporting costs, promote simplification and provide additional benefits to the not-for-profit community. An exposure draft is expected to be issued in mid-April with a comment period extending through at least July 31, 2015. An effective date for the new requirements was not suggested within the proposal.

Contact your trusted Maloney + Novotny team members, Jim Graham (216-344-5247) or Allen Waddle (216-344-5298) to discuss how these changes could/will affect your organization and what you should do to prepare for new reporting requirements.