



FASB Proposes Changes to Not-for-Profit Financial Statements

The FASB has invited constituents to comment on a proposed Accounting Standards Update (ASU) that would change the presentation of financial statements for not-for-profit entities, including health care entities.¹

Key Facts

The proposed ASU would:

- Reduce the number of net asset classes presented from three to two: *with donor-imposed restrictions* and *without donor-imposed restrictions*;
- Define two intermediate measures of operations and require their presentation; and
- Require presentation of operating cash flows using the direct method and recategorize items reported in the statement of cash flows to align with the proposed definition of operations in the statement of activities.

Comments on the proposed ASU are due August 20, 2015.

Key Impacts

- Eliminating the distinction between temporary and permanent restrictions from the financial statements would reduce reporting complexity and enhance understandability. These proposed changes are appropriate because state laws have changed, including de-emphasizing the historic dollar value for endowments in most jurisdictions.²
- Comparability across not-for-profits may be enhanced by defining operating activities, but complexity may increase. This definition may be inconsistent with how some not-for-profits currently view their operations or present their financial statements.
- Requiring operating cash flows to be presented using the direct method may enhance understandability and usefulness of information. However, re-categorization of cash flows may introduce complexity for users familiar with prior definitions, which also would continue to be used by business entities.

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¹ FASB Proposed Accounting Standards Update, Presentation of Financial Statements of Not-for-Profit Entities, available at www.fasb.org.

² The amount below which an organization could not spend from a donor-restricted endowment fund.

Changes to Net Asset Classifications

Current	Proposed
<ul style="list-style-type: none"> • Unrestricted • Temporarily Restricted • Permanently Restricted 	<ul style="list-style-type: none"> • Net Assets Without Donor Restrictions • Net Assets With Donor Restrictions



While some not-for-profits disclose information about board-designated net assets, there are currently no required disclosures except as they relate to endowment funds. Under the proposed ASU, disclosures would be required for all board-designated net assets, including those designated for a specific future expenditure.

The net asset classes would be reduced from three to two under the proposed ASU. However, not-for-profits would still be required to disclose information about the nature and amounts of donor-imposed restrictions. This disclosure would focus on both how and when the resources could be used rather than applying a bright-line distinction between temporary and permanent restrictions. Not-for-profits also would be required to disclose information about the amounts and purposes of board-designated net assets without donor restrictions.

Underwater Endowments

If the fair value of an individual donor-restricted endowment fund is less than the original gift amount required to be maintained by the donor or by law, that deficit would be reported in the *net assets with donor restrictions* class. Currently, these amounts are reported in the unrestricted net assets class. The proposed ASU also would require not-for-profits to disclose the governing board's policy on spending from underwater endowment funds (and whether this policy was followed), the original gift amount (or level required by donor stipulations or law) of underwater endowment funds in the aggregate, and the fair value of underwater endowment funds in the aggregate.

Intermediate Measures of Operations

Under the proposed ASU, the statement of activities would be separated into operating and non-operating activities on the basis of two dimensions.

Mission Dimension	Availability Dimension
<ul style="list-style-type: none"> • Resources that are from, or directed at, carrying out a not-for-profit's purpose for existence 	<ul style="list-style-type: none"> • Resources that are available for current period activities, considering both external and internal limitations

The proposed ASU would require all not-for-profits (including business-oriented health care entities) to present two measures (subtotals) associated with the change in net assets without donor restrictions in the statement of activities: (1) operating excess (deficit) before transfers, and (2) operating excess (deficit) after transfers.

The current performance indicator for business-oriented health care entities would become optional, rather than required.

While the definition of operations is principle-based, the proposed ASU does specifically address the reporting of certain transactions. The most significant ones are discussed below.

Investing and Financing Activities

Investing and financing activities would generally not meet the mission dimension and would therefore be classified as non-operating activities.

Capital Transactions and Events

Under the proposed ASU, gifts of long-lived assets without donor restrictions would be reported as operating revenues. Unless the gifted long-lived asset is sold, not-for-profits also would report a transfer out of operations for the entire amount of the gifted long-lived asset because the inherent long-term nature of the gifted asset makes it not fully available for current operations.

Purpose-restricted gifts of long-lived assets and gifts of cash restricted for acquisition or construction of long-lived assets would be reported initially as revenues that increase *net assets with donor restrictions* (i.e., outside of operations). Absent specific donor stipulations describing how long these assets must be used, not-for-profits would report the release from donor restriction when the asset is placed in service. The release would be reported as an increase in *net assets without donor restrictions* within operating activities and a decrease in *net assets with donor restrictions*. Consistent with the treatment of gifts of long-lived assets without donor restrictions, not-for-profits also would report a transfer out of operations for the entire amount in the same reporting period.

Board Designations, Appropriations, and Similar Transfers

All designations, appropriations, and similar transfers made by the governing board or its designees that affect current period operating activities (e.g., investment return appropriated for operations) would be shown in a separate section on the statement of activities between the two required subtotals, either in aggregate (*transfers in* would be separate from *transfers out*) or individually. If shown in aggregate, the details would need to be disclosed. Not-for-profits would be required to disclose the purpose, amounts, and types of transfers (e.g., whether the transfer occurred because of board policies, a one-time decision, or other reason).

Equity Transfers

Under the proposed ASU, equity transfers (i.e., between a parent and a subsidiary or entities under common control) would be reported within operating activities, unless they are not for the current period's use in carrying out the reporting entity's mission. These transfers would be reported separately from revenues, expenses, gains, and losses but included in the operating excess (deficit) before transfers.



The option to release restrictions over an asset's estimated useful life would be eliminated. Upon implementation, not-for-profits currently following this approach would generally need to immediately release any restricted net assets related to assets placed in service.

Changes to the Statement of Cash Flows

The direct method of reporting operating cash flows would be required for all not-for-profits under the proposed ASU. The reconciliation of net income (change in net assets) to net cash flows from operating activities, which is currently required for all statements of cash flows, including those prepared using the direct method, would no longer be required for not-for-profits.

The proposed ASU also would amend the classification of certain cash inflows and outflows to better align operating cash flows with the proposed definition of operations in the statement of activities.

Recategorized to Operating Cash Flows	Recategorized from Operating Cash Flows
<ul style="list-style-type: none"> • Cash payments to acquire and cash proceeds from the sale of long-lived assets (currently investing) • Cash gifts restricted for acquisition of long-lived assets (currently financing) 	<ul style="list-style-type: none"> • Cash receipts of interest and dividends (to investing) • Cash payments of interest on debt (to financing)



Voluntary health and welfare entities, which are currently required to present a statement of functional expenses, would be allowed the same flexibility in presentation as other not-for-profits.

Reporting of Expenses by Nature and Function

Not-for-profits would be required to report information about all expenses in one location (statement of activities, a schedule in the notes, or a separate financial statement). All operating expenses would need to be presented by both natural expense and functional expense classification. One option would be to provide the information in a matrix format, but no specific format is prescribed. Non-operating expenses would be reported by natural expense classification; reporting by function would be optional.

Disclosures Required for Expense Allocations

Certain categories of expenses are attributable to more than one program or supporting service expense category and therefore require allocation. Qualitative disclosure of the methods used to allocate costs among program and supporting service categories would be required. The proposed ASU refines the definition of management and general activities and includes additional examples of the types of activities included in this category. Additional implementation guidance is also included to better depict which activities represent direct conduct and direct supervision of program or support activities and would be allocated to the program and/or support function that receive the benefit.

Presentation of Investment Return and Expenses

Not-for-profits would no longer be required to disclose the components of investment return. The proposed ASU also eliminates the requirement to disclose the amount of investment expenses and the option to report these amounts within total expenses. All not-for-profits would be required to net investment expenses against investment return. The netted investment expenses would be limited to external and direct internal investment expenses incurred during the period. When internal salaries and benefits are netted against investment return, the total would need to be disclosed.

Additional Liquidity Disclosures

Not-for-profits would be required to define the time horizon used to manage liquidity (e.g., 30, 60, or 90 days) and disclose the following quantitative and qualitative information.

Quantitative Information	Qualitative Information
<ul style="list-style-type: none"> • Total amount of financial assets • Amounts that, due to external or internal limitations, are not available to meet cash needs within the defined time horizon • Total amount of financial liabilities due within the defined time horizon 	<ul style="list-style-type: none"> • How liquidity is managed, for example: <ul style="list-style-type: none"> – Strategy for addressing entity-wide risks that may affect liquidity – Policy for establishing liquidity reserves – Basis for determining the time horizon used to manage liquidity

Effective Date and Transition

The FASB did not propose an effective date. Instead, one will be determined after considering constituents' comments. Retrospective application of the proposed changes would be required upon application. In the initial year of application, the annual financial statements would disclose the nature of any reclassifications or retrospective adjustments and their effects on the change in the net asset classes for each year or period presented. However, interim financial statements would not need to reflect the standard's application in the initial year of application.

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