



## Accounting Standards Update for Nonprofit Community



On August 18, 2016, the Financial Accounting Standards Board ([FASB](#)) announced the long anticipated "Accounting Standards Update (ASU)" which will go into effect for annual financial statements issued for fiscal years beginning after December 15, 2017. These new guidelines, the first changes to be made in 20 years, are the result of a six-year process that included input and feedback from many key stakeholders. In fact, according to the [American Institute of CPAs](#) (AICPA), this update "Will change the way all not-for-profits (NFPs) classify net assets and prepare financial statements."

While the currently used nonprofit financial reporting model was an effective tool for more than two decades, over the years concerns have been voiced about the complexity, insufficient transparency, and limited usefulness of certain aspects. These were the concerns that FASB Chair Russell G. Golden specifically focused on when announcing the update.

The new guidelines, which represent the first of two phases on the FASB project, will address these concerns and will simplify and improve the face of the financial statements while enhancing the disclosures in the footnotes by improving the current net asset classification requirements and the information presented in financial statements and in the notes section regarding a nonprofit entity's liquidity, financial performance and cash flows. All of the changes will enable nonprofit organizations like yours to better and more accurately communicate your financial performance to your stakeholders.

Most of the major changes will impact the following areas:

### Net Asset Classes

The significant change in this area is that the current three classes of net assets will be reduced to only these two:

1. Net assets with donor restrictions. The part of net assets of a nonprofit entity that is subject to donor-imposed restrictions (donors include other types of contributors, including makers of certain grants).
2. Net assets without donor restrictions. The part of net assets of a nonprofit entity that is not subject to donor-imposed restrictions (donors include other types of contributors, including makers of certain grants).

These two classes will replace the three existing classes of net assets which are *unrestricted*, *temporarily restricted*, and *permanently restricted*. This will change the way the statement of financial position (balance sheet) and the statement of activities (income statement) will be presented. In addition, the composition of net assets with donor restrictions at the end of the period will be disclosed as well as how the restrictions will affect the use of resources.

The update will also require the enhanced disclosures about the amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period.

Note: Underwater endowments, those with a current fair value that is less than the original gift amount (or amount required to be retained by donor or by law) will require disclosures of the nonprofit's policy and any actions taken during the period concerning appropriation from underwater endowment funds will be disclosed as will the aggregate fair value of such funds along with the aggregate of the original gift amounts (or level required by donor or law) to be maintained and the aggregate amount by which funds are underwater and which are to be classified as part of net assets with donor restrictions.

### **Investment Return**

Investment returns must be reported net of external and direct internal investment expenses and no longer will require disclosure of those netted expenses.

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### **Expenses**

Going forward, expenses will be disclosed by both their natural classification and their functional classification (e.g., program service, general and administrative, or fundraising costs). That analysis of expenses is to be provided in one location, which could be on the face of the statement of activities, as a separate statement or in notes to financial statements.

Methods used to allocate costs among program and support functions will be enhanced by these updates.

### **Liquidity and Availability of Resources**

Qualitative information will communicate how a nonprofit manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date.

Quantitative information, either on the face of the balance sheet or in the notes, and additional qualitative information in the notes as necessary, will communicate the availability of a nonprofit's financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date.

The availability of a financial asset may be affected by several factors including its nature, any external limits imposed by donors, grantors, laws, and contracts with others and any internal limits imposed by governing board decisions.

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### **Presentation of Cash Flow Information**

Under the new standard, nonprofits may continue to present cash flows from operations using either the direct or indirect method. However, they will no longer be required to present the indirect method reconciliation if the direct method is used. The intent of this change is to allow an organization to select the presentation method that best serves its needs, thus providing greater flexibility in financial reporting.

### **In Conclusion**

The updates highlighted here are important to you because, as you know, accounting practices influence the financial picture you present to the community. How you are perceived by donors, volunteers, watch dog groups and other stakeholders is in great part a reflection of your financial stability. The updates will enable you to provide a more easily understood and transparent report for your constituents.

To speak with us regarding the Update and its specific impact on your nonprofit organizations, please call us at 973-994-9494 or you can email us at [bridget.hartnett@sobel-cpa.com](mailto:bridget.hartnett@sobel-cpa.com) or [ron.matan@sobel-cpa.com](mailto:ron.matan@sobel-cpa.com)

We will be happy to help you!