ARE YOU COMPLIANT?

Understanding the new nonprofit financial reporting standards

by Nathan Salsbery

Financial statements play an essential role in nonprofit organizations, giving leadership, donors, grantors and others insight into the organization's financial position. But they can be hard for those without a business background to read and understand.


FINANCIAL ACCOUNTING SERIES

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Not-for-Profit Entities (Topic 958)

Presentation of Financial Statements of Not-for-Profit Entities

An Amendment of the FASB Accounting Standards Codification®

Financial Accounting Standards Board

With Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* — the first substantive modification of nonprofit financial reporting since 1993 — nonprofit financial statements should become easier to understand. ▸

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A Financial Reporting Upgrade

The purpose of ASU 2016-14 is to update, not overhaul, the existing financial reporting model. It is intended to improve the presentation of financial information for nonprofit entities and provide more relevant information about their liquidity, financial performance, expenses and cash flows.

You can think of this as an "upgrade" to your camp or conference center's financial statements. And just as upgrading software or an operating system can require installation time and a learning curve, implementing the new financial reporting standards will take time, adjustment and careful planning.

ASU 2016-14 is in effect for fiscal years beginning after Dec. 15, 2017, and it's essential to start the implementation process now. If you've already started, the information that follows can provide some key items of what the process should entail.

Net Assets

One of the most significant changes in the new standards is to the reporting and disclosure of net assets. Previously, net assets were reported in three categories. This has been simplified to two categories: net assets with donor restrictions (combining what was previously the temporarily and permanently restricted net asset categories) and net assets without donor restrictions (previously classified as unrestricted net assets). The goal is to reduce complexity, increase understanding and provide readers with more relevant information they can use to identify and assess key trends in the organization's finances.

Endowment Funds

If a donor-restricted fund is "underwater" (meaning that it has depreciated in value below the original value of the gift), the aggregate by which the fund is underwater is classified within net assets with donor restrictions. Underwater endowment funds were previously shown as offsets to unrestricted net assets.

You also are required to disclose the policy to reduce expenditure or not spend from underwater endowment funds as well as the aggregate of the fair value, original endowment gift amount or level required to be maintained and amount of deficiencies.

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Expense Reporting

Another significant change that will affect many camps and conference centers is expense reporting. Previously, most nonprofits reported expenses in broad categories such as general and administrative, program and fundraising. The new standards require you to report all expenses (other than netted investment expenses) by function and natural classification in one location, either on the statement of activities, in a separate statement or the notes to the financial statements.

The new standards also require a description of the methods used to allocate costs among program and support functions. This means you will now need to report total salaries and benefits, as well as other natural categories of expenses.

Liquidity and Other Required Disclosures

ASU 2016-14 also requires several new disclosures. This includes disclosures designed to provide information useful in assessing an organization's liquidity, regardless of the appearance of financial health on the face of the statement of financial position.

Under the new standards, you must provide qualitative information in the notes that communicates how your organization manages its liquid resources available to meet the cash needs for general expenditures within one year of the balance sheet date. You must also provide quantitative information either on the balance sheet or in the notes that communicates the availability of financial assets at the balance sheet date to meet the cash needs for general expenditures within one year of the balance sheet date. This information will show how your organization will achieve its current obligations within one year.

Note that FASB will allow nonprofits to be exempt from presenting the liquidity disclosure comparatively in the year of adoption. This is meant to make adopting the ASU easier and to encourage nonprofits to maintain comparative financial statements in the year of adoption.

Additional changes in ASU 2016-14 include disclosures around investment return and related expenses and reporting when using an operating measure.

Photo courtesy of Word of Life Fellowship

Statement of Cash Flows

Nonprofits still have the flexibility to report operating cash flows using either the direct or indirect method, based on the needs of their financial statement users. However, to encourage organizations to use the direct method, FASB removed the requirement to provide indirect reconciliation when using the direct method.

In the direct method, cash flows from operating activities are shown in line items such as cash received from contributions, service recipients and other income; cash paid to employees; and cash paid for interest, grants and other activities. In other words, in the direct method, line items show where your cash comes from and where it goes.

Note that FASB encourages nonprofits to report cash flows from operating activities directly by showing major classes of operating cash receipts and payments, which may be more useful to a wide range of users.

An Opportunity for Improvement

Just as a software upgrade can lead to improved performance, this upgrade to nonprofit financial reporting is an excellent opportunity to improve the financial information you provide to key users of your camp or conference center's financial statements. Use this process to consider how you can better tell the story of your organization's financial health. ■

Photo courtesy of Grace Adventures

Implementing Best Practices

Steps for incorporating the recent changes to your financial reporting

Thoughtful preparation will make adoption of the new financial reporting standards easier. Start by creating an implementation plan that includes these tasks:

- Check your organization's liquidity.
- Check your ratios.
- Assess your cost allocation methods and contact your IT team now if you don't currently allocate.
- Work on expense analysis by nature and function so you can address format issues sooner rather than later.
- Update your statement of financial position and statement of activities to reflect the two net asset categories.
- Review the notes to your financial statements and update your wording to reflect the two net asset classes.
- Consider the effects on prior-year financial statements.
- Consider whether you want to make other format changes. You may want to involve key leadership members for their thoughts on how to best report your financial information and create the most useful statement possible.

We recommend that you stay up to date by subscribing to FASB Action Alerts and accessing other resources at www.fasb.org. More accounting standards updates are on the horizon, including changes to accounting for leases, revenue recognition and contributions.

Nathan Salsbery is a partner and executive vice present at CapinCrouse, a national CPA and consulting firm devoted to serving nonprofit organizations. For nearly 20 years, Nathan has provided various assurance and consulting services to numerous types of nonprofit organizations, and he is a certified fraud examiner. Nathan serves as a board member and treasurer for the Christian Leadership Alliance.

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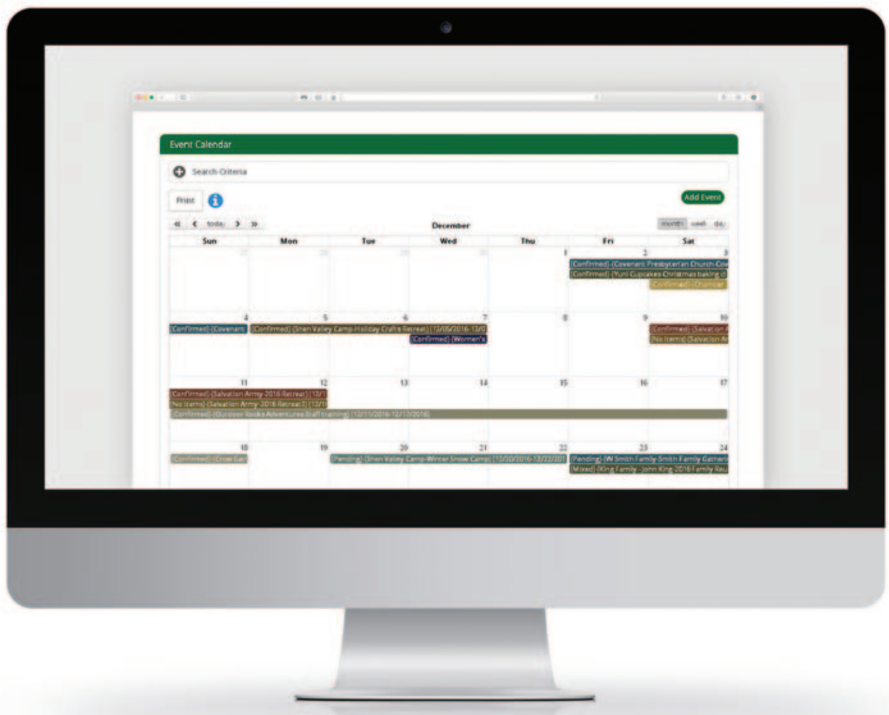

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