Financial Accounting Standards Board
Accounting Standards Update
No. 2016-14
Not-for-Profit Entities (Topic 958)
Presentation of Financial Statements of Not-for-Profit Entities

Certified Public Accountants ▪ Business & Financial Advisors

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Executive Summary

Accounting Standards Update (ASU) No. 2016-14 (Update) issued by the Financial Accounting Standards Board (FASB) is the most significant change to financial statement presentation for Not-for-Profits (NFP's) since 1993. The Update represents Phase I of II potential updates, and the FASB is still deliberating on the second phase. Some of the most significant changes included in the Update are:

⇒ Net assets will no longer be presented as three classes (unrestricted, temporarily restricted, and permanently restricted) they will now be presented as two distinct classes (with donor restrictions and without donor restrictions).

⇒ Additional disclosures will now be required regarding an NFP's liquidity (both qualitative and quantitative), composition of net assets, and self-imposed restrictions.

⇒ All NFP's will now be required to present functional expenses (either as a statement or in the notes) along with the allocation methodology.

⇒ Enhanced disclosures regarding underwater endowment funds will be required.

⇒ Investment return will be presented as a net amount (net of direct internal and external investment expenses) and these netted expenses will not require disclosure.

⇒ If the direct method is presented for the statement of cash flows, there will no longer be a requirement to reconcile to the indirect method.

⇒ The placed-in-service approach will be required when releasing net assets for capital expenditures (rather than releasing over the asset's useful life).

Implementation is effective for annual periods with fiscal years beginning after December 15, 2017:

Example implementation year:	**For comparative statements:**
Calendar year-end - December 31, 2018	Retrospective to December 31, 2017
Fiscal year-end - June 30, 2019	Retrospective to June 30, 2018

Implementation effective for interim periods with fiscal years beginning after December 15, 2018

Early application is permitted.

Functional expenses and liquidity disclosures do not require retrospective application.

Implementation Guidance

On Thursday August 18, 2016, the Financial Accounting Standards Board (FASB) issued the much anticipated Accounting Standards Update (ASU) No. 2016-14 (Update). The Update impacts the Accounting Standards Codification Topic 958, Not-for-Profit (NFP) Entities, with a specific impact to sections of the Codification related to the presentation of the financial statements for NFP's. These changes were brought by the FASB primarily to improve the clarity of NFP financial statements and the Update represents the conclusion of Phase I of II. Phase II will involve more complex or contested presentation matters and may take many years to reach the point of implementation.

Our NFP team at Mueller has been working diligently to keep abreast of the proposed changes and has participated in trainings and other continuing education to ensure we are prepared to assist our clients with the implementation of the Update. Unlike most ASU's released by the FASB, which have a targeted impact on a specific aspect of financial reporting, the changes in the Update have a sweeping impact. While not all of the changes in the Update will impact all NFP's, a significant portion of the Update will affect all NFP's. Below is a brief summary of the changes included in the Update:

Net-Asset Classifications

Currently, NFP's are required to present net assets under one of three different classifications - unrestricted, temporarily restricted, or permanently restricted. Net assets are classified based on the existence or non-existence of donor restrictions, and if restrictions are present, the type and extent of those restrictions. When the Update is adopted, NFP's will present only two classes of net assets, *net assets with donor restrictions* and *net assets without donor restrictions* on the face of the financial statements. The FASB Board of Directors anticipated that this change would reduce confusion by users of an NFP's financial statements.

Example presentation on the statement of financial position:

Net assets:			
Without donor restrictions	$	92,677	73,619
With donor restrictions		193,413	197021
Total net assets		286,000	270,640
Total liabilities and net assets	$	296,720	282,980

Statement of Cash Flows

Currently, NFP's must present the statement of cash flows under either the indirect method or the direct method with reconciliation to the indirect method. When the Update is adopted, NFP's will be permitted to present cash flows using either the indirect method or the direct method. There will no longer be a requirement for a reconciliation to be performed from the direct method to the indirect method if the direct method is used.

Investment Return

Currently the external and direct internal expenses associated with investment return need to be disclosed. When the Update is adopted, investment return will be reported net of external and direct internal expenses and there will be no disclosure required regarding the netted expenses.

Gifts of Cash or Other Assets Used to Acquire or Construct Long-Lived Assets

When the Update is adopted, any gift of cash or other assets received for the purpose of acquiring or constructing long-lived assets that are received without explicit donor stipulations will be required to use the in-service date for reporting the release of the donor restriction. Net assets will be released from *net assets with donor restrictions* to *net assets without donor restrictions* for any long-lived assets constructed or acquired using such funds as of the beginning of the period in which the Update is adopted. This will be a change from current application, which permits the release of the donor restriction over the asset's estimated useful life.

Enhanced Disclosures

Liquidity Disclosures

When the Update is adopted, NFP's will be required to report any limits on the use of resources imposed by the governing board or by other means that limit the use of resources that are included as *net assets without donor restrictions*. These restrictions will be reported if they exist at the end of the reporting period.

This disclosure will also require quantitative disclosure on the face of the financial statements or in the notes that describes the availability of financial assets to meet cash needs for general expenditures. Limits on financial resources may be imposed by its nature, donor restrictions, laws, contracts, governing board decisions, or other means. For those resources that are considered liquid and available to meet cash needs for general expenditures, the NFP will need to communicate qualitatively how these liquid resources will be managed to meet cash needs for general expenditures within one year from the date of the statement of financial position.

Example presentation of liquidity disclosure:

Financial assets, at year-end*	$ 234,410
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(11,940)
Subject to appropriation and satisfaction of donor restrictions	(174,700)
Investments held in annuity trust	(4,500)
Board designations:	
Quasi-endowment fund, primarily for long-term investing**	(36,600)
Amounts set aside for liquidity reserve	(1,300)
Financial assets available to meet cash needs for general expenditures within one year	$ 5,370

*Total assets, less nonfinancial assets (e.g., PP&E, inventory, prepaids)

**Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions.

Example of additional liquidity disclosures:

NFP A's financial assets available within one year of the balance sheet date for general expenditure are as follows:

Cash and cash equivalents	$	4,575
Accounts and interest receivable		2,130
Contributions receivable		1,825
Short-term investments		1,400
Other investments appropriated for current use		10,804
	$	20,734

NFP A's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from do not-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. As described in Note Y, the quasi-endowment has a spending rate of 5 percent. $1.65 million of appropriations from the quasi-endowment will be available within the next 12 months.

As part of NFP A's liquidity management, is has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, NFP A invests cash in excess if daily requirements in short-term investments. To help manage unanticipated liquidity needs, NFP A has committed lines of credit in the amount of $20 million, which it could draw upon. Additionally, NFP A has a quasi-endowment of $33 million. Although NFP A does not intend to spend from its quasi-endowment other amounts appropriated for general expenditures as part of its annual budget approval and appropriation process, amounts from its quasi-endowment could be available if necessary. However, both the quasi-endowment and donor-restricted endowments contain investments with lock-up provisions that would reduce the total investments that could be made available (see Note X for disclosures about investments)

Net Assets with Donor Restrictions

When the Update is adopted, NFP's will be required to report the composition of *net assets with donor restrictions* and the impact those restrictions have on the NFP's use of those resources as of the end of the period.

Example disclosure:

Subject to expenditure for specified purpose:		
Program A activities:		
Purchase of equipment	$	3,060
Research		950
Educational seminars and publications		240
Program B activities:		
Disaster relief		745
Educational seminars and publications		280
Program C activities and general		210
Building and equipment		2,150
Annuity trust agreements for research		2,815
		10,450
Subject to the passage of time:		
For periods after June 30, 20x1		3,140
Subject to NFP spending policy and appropriation:		
Investments perpetuity (including amounts above original Gift amount of $122,337), which, once appropriated, is expendable to support:		
Program A activities		33,300
Program B activities		15,820
Program C activities		16,480
Any activities of the organization		109,100
		174,700
Subject to appropriation and expenditure when a specified event occurs:		
Endowment requiring income to be added to original gift until fund's value is $2,500		2,120
Paid-up life insurance policy that will proceeds upon death of Insured for an endowment to support general activities		80
		2,200
Not subject to appropriation or expenditure:		
Land required to be used as a recreation area		3,000
	$	193,490

Functional Expenses

When the Update is adopted, all NFP's will be required to report expenses by their natural and functional classifications, as well as, to disclose the method or methods used to allocate costs among program and support functions. Prior to the Update, these disclosures were only required of health and welfare organizations.

Underwater Endowment Funds

Additional disclosures for underwater endowment funds will be required when the Update is adopted. These disclosures will need to present that fair value of the funds as of the date of the statement of financial position, any appropriations from the underwater endowment during the period and the NFP's policy regarding such, the amount of the original gift required to be maintained whether by stipulation or by law, and the amount underwater, which will be reported with *net assets without donor restrictions*.

Adoption of the Update will be required for fiscal years beginning after December 15, 2017, however early adoption is permitted. In the year of adoption, all portions of the Update will need to be retrospectively applied if comparative financial statements are issued, except for disclosures involving liquidity and those related to functional expenses.

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