A Project Update on Not-for-Profit Entities

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On November 9, 2011, the Financial Accounting Standards Board ("FASB") chairman announced the addition of two projects intended to improve financial reporting for not-for-profit entities. Since that time, ongoing discussions have been held with a project resource group as well as members of the Not-for-Profit Advisory Committee (NAC). The projects are focusing on improving (1) net asset classification requirements and (2) information provided in financial statements and disclosures about liquidity, financial performance, and cash flows. The FASB met and discussed updates as recently as July 23, 2014. Although nothing is finalized, we thought our readership would be interested in potential developments that would significantly impact financial reporting for not-for-profits, likely including health care organizations. The following is a summary of some of the proposed changes currently being discussed.

Net Assets

Under the FASB Codification, there are currently three classes of net assets: *unrestricted, temporarily restricted*, and *permanently restricted*. It has been tentatively decided to reduce this to two classes of net assets: *with donor-imposed restrictions* and *without donor-imposed restrictions*. Along with this, there will be proposed changes to the terminology and definition of the net asset classes.

The current requirement to provide information about the nature and types of donor-imposed restrictions is expected to remain. However, the distinction between temporary restrictions and permanent restrictions will be removed in favor of describing differences in restrictions with a focus on both how and when the net assets can be used. The disclosure regarding the amount and purpose of board designated net assets without restrictions will remain.

The treatment of underwater endowments is expected to change. An endowment is considered underwater if the fair value of the fund is less than the original gift amount or level required by the donor's stipulation(s) or law. These endowments will be reported within the class of net assets *with donor-imposed restrictions.* Additionally, the following will be required to be disclosed for underwater endowments:

- The board's policy on whether or not to spend from these funds
- The original gift amount (or level required by the donor's stipulation(s) or law) of the collective total of these funds
- The collective fair value of these funds.

Statement of Cash Flows

The statement of cash flows will experience some changes as well. Currently, not-for-profit entities have the option of using either the indirect or direct method of reporting cash flows. It is tentatively decided that the direct method of reporting cash flows will be required, thus removing the requirement to reconcile the change in net assets to net cash flows from operating activities.

Some cash flow designations are expected to be revised to better align with other proposed report changes. Anticipated changes include:

- Cash gifts with donor-imposed restrictions that require they be used to obtain long-lived assets for operating purposes will be moved from financing to operating
- Cash payments to obtain long-lived assets for operating purposes will be moved from investing to operating
- Cash proceeds from the sale of long-lived assets will be moved from investing to operating
- Cash dividends and interest income will move from operating to investing
- Cash payments of interest expense will move from operating to investing.

Liquidity

It is expected that there will be an increased focus on liquidity disclosures. Among the disclosures that are tentatively decided upon is the requirement of an entity to define the time horizon it uses to manage its liquidity (such as 30 days, 90 days, 6 months, etc) as well as qualitative and quantitative information that is useful in assessing liquidity. The qualitative information would be designed to allow the users of the financial statement to understand how the entity manages its liquidity. This may include items such as how the horizon was determined, strategies to assess risks affecting liquidity, and policies for establishing reserves. The quantitative information would include:

- The total amount of financial assets
- The amounts that are not available to meet cash needs within the defined time horizon due to various limitations
- The total amount of financial liabilities that are due within the defined time horizon.

Future Impact

At this time, discussions related to this project are ongoing without a specified time frame, with many steps ahead before being released as a final standard update. Upcoming discussion topics include not-for-profit specific disclosures and implementation issues. Once an exposure draft is released, the public will have the opportunity to comment and offer suggestions. This input will help determine what remains in the final standard. Stay tuned as the FASB navigates through this process to learn how the changes will impact your financial reporting.

Contact us with questions about these or any other accounting matters you may have.

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