Not-for-Profit: Presentation of financial statements

Issues In-Depth

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Contents

Scaled-back changes, but still significant

What began in 2011 as an ambitious proposal to improve financial reporting for not-for-profit entities (NFPs) was divided into two phases to separate the non-controversial changes from those that require additional research or are tied to other FASB projects.

Despite the smaller scope, the new standard will significantly affect how NFPs, including private colleges and universities, charities, foundations, health care providers, religious organizations and trade associations, report net asset classes, expenses, investment return and liquidity in their financial statements. These changes represent the first major changes to NFP financial statement presentation in more than 20 years. These changes had broad support, were not dependent on other FASB projects, and resulted in the recently issued Accounting Standards Update 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities.*

The FASB deferred its more controversial proposals, which include requiring the same defined measure of operations for all NFPs, to Phase 2.

This publication reflects our summary of the key changes in the standard as well as some insights into the FASB's reasoning behind the key changes to NFP financial reporting. We also provide some illustrations that we hope will be helpful as you implement the standard. While this publication is an in-depth analysis, it is not meant to be a substitute for the standard, and does not cover all aspects of the changes. We hope that a careful read of our document together with the specific changes in the FASB's codification will help you implement the new standard.

Please speak to your usual KPMG contact if you face implementation challenges or would like to discuss any other accounting issues.

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Executive summary

The FASB's new accounting standard brings significant changes to how NFPs, including health care (HC) entities, report net asset classes, expenses and liquidity in their financial statements.

The most significant change that you will notice is that the new standard reduces the number of net asset classes presented from three to two: *with donor restrictions* and *without donor restrictions.*

The standard also requires NFPs to:

— present expenses by their functional *and* their natural classifications in one location in the financial statements;

— present investment return net of external and direct internal expenses; and

— disclose quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date.

However, the standard retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method.

By making these changes, the FASB intends to reduce reporting complexity and enhance understandability by eliminating the distinction between temporary and permanent restrictions. Additionally, the FASB hopes to provide financial statement users with greater transparency about how an NFP uses its resources by requiring them to present expenses by both their nature and function. The enhanced liquidity and availability disclosures are intended to provide financial statement users with helpful information about how NFPs manage their cash needs and how limits on resources may affect liquidity and financial flexibility.

1 Background

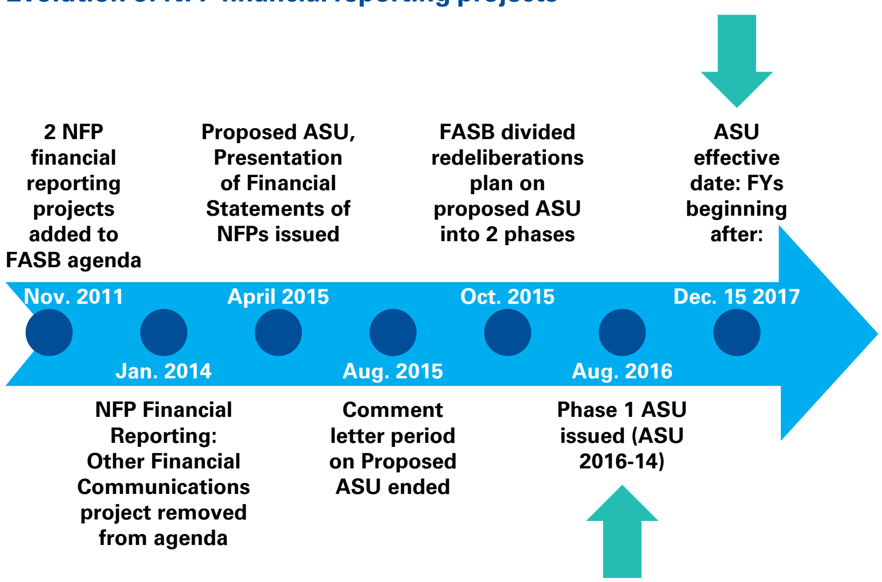
In 2011, the FASB added two projects to its agenda to improve NFPs' financial reporting.[1]

— Not-for-Profit Financial Reporting: Financial Statements of Not-for-Profit Entities; and

— Not-for-Profit Financial Reporting: Other Financial Communications

Based on discussions with the FASB's Not-for-Profit Advisory Committee (NAC) and other constituents, the FASB concluded that the existing standards for NFP financial reporting are generally sound but it was time to take a fresh look at them to determine what improvements should be made.

Evolution of NFP financial reporting projects



[1] See the FASB's project page for more information, available at www.fasb.org.

Financial statements project

The financial statement project's purpose was to improve:

— net asset classification requirements; and

— information about liquidity, financial performance and cash flows.

Statement 117 governs current financial statement presentation for NFPs.[2] It remained unchanged since its issuance in 1993, other than a few technical amendments to provide interpretative guidance. In April 2015, the FASB proposed changes to implement its findings in the financial statements project.[3] The proposed changes generally did not change requirements for recognition and measurement of assets, liabilities, revenues or expenses but focused on how these items are presented and disclosed.

Public feedback about the proposed changes was significant and mixed. The FASB received more than 250 comment letters, held 3 public roundtables and 10 workshops and made many calls to gather information. While there was general support for the proposed changes to net asset classification and reporting of expenses and investment return, other proposed changes generated negative feedback. These proposed changes related to the requirement that all NFPs present intermediate measures of operations, as defined by the FASB, as well as related changes to the statement of cash flows. The FASB decided to divide the project into two phases.

Phase 1	Phase 2
These changes had broad support, did not depend on other projects and are improvements the FASB could make quickly	These changes are controversial and will require additional research
— Net asset classification » Combining restricted classes » Disclosure of board designations » Underwater endowments » Expiration of capital restrictions — Expenses » Expenses by nature and function » Investment expenses » Cost allocation disclosures — Operating measures » Additional disclosures by those that choose to present such a measure — Liquidity » Additional disclosures — Methods of presenting operating cash flows in the statement of cash flows	— Intermediate measure of operations » Whether to require this for all NFPs » Whether and how to define it » Alternative approaches suggested by stakeholders — Realignment of certain items in the statement of cash flows to align with the measure of operations

[2] FASB Statement No. 117, Financial Statements of Not-for-Profit Organizations, (FASB ASC Topic 958, Not-for-Profit Entities), available at www.fasb.org.

[3] FASB Proposed Accounting Standards Update, Presentation of Financial Statements of Not-for-Profit Entities, April 22, 2015, available at www.fasb.org.

Phase 1

This publication discusses Phase 1, which culminated in the issuance of ASU 2016-14.

Phase 2

The FASB deferred decisions about the intermediate measure of operations to Phase 2. While many NFPs agreed with displaying an operating measure in the statement of activities, there was limited support for the FASB's proposed definition of operations and the requirement for all NFPs to use this definition. Eliminating the performance indicator for NFP business-oriented HC entities also met strong opposition. Many constituents also did not want to move forward with the FASB's proposed changes when it was still in the very early stages of exploring this topic for business entities in another project on financial performance reporting.[4]

The FASB has not said when it will complete Phase 2, which may depend on the progress of its financial performance reporting project. For further discussion of the FASB's Phase 2 proposals, refer to our previous *Issues In-Depth*.[5]

Other financial communications project

The second project that was added in 2011 was aimed at studying other ways that NFPs could use to tell their financial story. The FASB's research found that these communication methods, such as management's discussion and analysis, were most prevalent in the higher education and health care industries and among larger NFPs. However, their form varied greatly.

Many FASB board members expressed concern that providing guidance for communications outside the basic financial statements extended beyond the norm of the FASB's traditional activities. The FASB also discussed the availability of its resources and the need to prioritize its efforts on immediate standard-setting initiatives such as its convergence projects. The FASB ultimately removed this research project from its agenda in 2014.

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[4] More information about the FASB's Financial Performance Reporting project is available at www.fasb.org.

[5] KPMG's Issues In-Depth, FASB's Proposed Changes to Not-for-Profit Financial Statements, May 2015, available at kpmg/com/us/frn.

2 Changes to net asset classifications

The FASB replaced the three existing net asset classes with two new net asset classes that eliminate the distinction between temporary and permanent restrictions. However, NFPs must still disclose information about the nature and amounts of donor-imposed restrictions. Additionally, NFPs must now disclose information about the amounts and purposes of board designations of net assets without donor restrictions.

Current US GAAP	Standard
— Unrestricted	— Net assets without donor restrictions
— Temporarily restricted — Permanently restricted	— Net assets with donor restrictions

Net assets without donor restrictions

The FASB renamed *unrestricted net assets* as *net assets without donor restrictions*. [958-205-05-6]

KPMG observation – Terminology is now more precise

Unrestricted net assets has been defined as the part of net assets that is neither permanently nor temporarily restricted by donors. However, some users interpreted this term more broadly to conclude that there were no other restrictions such as legal or contractual ones. This misconception sometimes led to incorrect conclusions when assessing an NFP's liquidity or financial flexibility. The FASB made the terminology more precise to avoid these misconceptions.

Net assets with donor restrictions

The FASB combined the two remaining net asset classes, *temporarily restricted* and *permanently restricted*, to create a *net assets with donor restrictions* class. [958-205-05-6]

KPMG observation – Combined restricted net asset class aligns with UPMIFA's principles

The distinction between temporary and permanent became blurred when the model Uniform Prudent Management of Institutional Funds Act (UPMIFA) was approved by the Uniform Law Commission in 2006 and subsequently enacted into law by most states.

UPMIFA governs the investment and management of endowment funds by NFPs. UPMIFA de-emphasized the concept of historic dollar value (original gift amount). Thus it changed the focus from the prudent spending of net appreciation of funds to prudent spending from the entire donor-restricted endowment fund (i.e. the original gift amount plus accumulated earnings).

UPMIFA permits NFPs to spend, within bounds of prudence, from a donor-restricted endowment fund even in circumstances where the fair value of the endowment has fallen below the original amount of the gift. This change in focus essentially allowed spending from the portion of net assets classified as permanently restricted under current US GAAP.

There was intense debate in the NFP community about whether the adoption of UPMIFA should affect the net asset classification of donor-restricted endowment funds. Some constituents proposed restructuring the net asset classification model so the entire endowment fund would be classified in one net asset class. However, this view was rejected when the FASB ultimately issued guidance in 2008.[6]

The net asset classification model and the portion of donor-restricted endowment funds classified as permanently restricted by NFPs remained largely unchanged (i.e. generally historic dollar value). The FASB's 2008 guidance also indicated that the remaining portion of donor-restricted endowment funds (i.e. accumulated gains) should be classified as temporarily restricted net assets until appropriated for expenditure by the NFP.

The FASB's decision to now combine the two restricted net asset classes and therefore present the entire donor-restricted endowment fund in one net asset class is more in line with the changes in the law resulting from UPMIFA.

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[6] FASB Staff Position No. FAS 117-1, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds (subsequently codified into Topic 958), available at www.fasb.org.

Underwater endowments

The fair value of an individual donor-restricted endowment fund may be less than the amount of the original gift or the amount that the donor or law requires the NFP to maintain. Currently, NFPs report this deficiency (accumulated losses) in *unrestricted net assets*. Under the standard, NFPs will report this deficiency in *net assets with donor restrictions*. [958-205-45-13H]

KPMG observation – Net asset classification now aligns with UPMIFA's principles

In 2008, the FASB retained its guidance that classified donor-restricted underwater amounts within unrestricted net assets. However, continuing to include these underwater amounts in the unrestricted net assets class created misconceptions. This categorization implied that these deficiencies would need to be funded or repaid from unrestricted sources, which conflicted with UPMIFA's principles.

Classifying these amounts with the remainder of the donor-restricted endowment fund in the net assets with donor restrictions class better reflects UPMIFA's principles. UPMIFA incorporates the view that institutions invest their endowments using a total-return approach, which may result in fluctuations in the fund's value. UPMIFA allows institutions to determine spending based on the total assets of the fund.

However, while UPMIFA de-emphasized the distinction of principal versus income, institutions still must track principal under UPMIFA. In fact, as the drafters of UPMIFA have stated:

> Although the Act does not require that a specific amount be set aside as "principal," the Act assumes that the institution will act to preserve "principal"…while spending "income" (i.e. making a distribution each year that represents a reasonable spending rate, given investment performance and general economic conditions). Thus an institution should monitor principal in an accounting sense, identifying the original value of the fund (the historic dollar value) and the increases in value necessary to maintain the purchasing power of the fund.[7]

[7] National Conference of Commissioners on Uniform State Laws, Uniform Prudent Management of Institutional Funds Act (2006).

Example 2.1

Presentation of donor-restricted endowment funds

	Original gift (corpus) amount	Change in value	Value on June 30, 2016	Amount reported under current GAAP on June 30, 2016	Amount reported under the standard on June 30, 2016
Gift A	$105m	($5m)	$100m	$105m permanently restricted net assets ($5m) unrestricted net assets	$100m net assets with donor restrictions
Gift B	$75m	$25m	$100m	$75m permanently restricted net assets $25m temporarily restricted net assets	$100m net assets with donor restrictions

KPMG observation – Net asset classification changes will have broader implications

The changes to the FASB's net asset classification model for NFPs will have implications outside the financial statements, including the following issues.

Financial covenants

Debt agreements may include financial covenants that are based on the current net asset classification requirements. NFPs should consider discussing with bond counsel and debt holders to determine whether any amendments to their debt agreements are necessary.

IRS Form 990

The IRS Form 990 currently requires NFPs to report financial information by net asset classes based on the current net asset requirements. We understand that it will take some time for the IRS to revise the form to incorporate the changes in net asset classes. We expect that the IRS will provide instructions to tell NFPs how they can continue to use the current form to report net asset information after implementation of the standard. The timing of these instructions from the IRS is uncertain.

Financial responsibility ratios

Colleges and universities participating in student financial assistance programs of the US Department of Education (Education Department) must comply with the standards of financial responsibility that it published in 1997. The standards include a composite score based on the institution's primary reserve, equity and net income ratios. These ratios are based on the net asset terminology in Statement 117 (Topic 958).

A Senate task force recently indicated that the Education Department has not kept up with changes in accounting practices in applying the ratios.[8] The Senate task force referred to an earlier study by the National Association of Independent Colleges and Universities (NAICU).[9] The Senate task force noted that the study concluded that the Education Department regulators "were not using generally accepted accounting standards...in calculating the financial ratios." For example, the report found that the Education Department was treating endowment losses as expenses and excluding accumulated endowment earnings from temporarily restricted net assets when calculating the primary reserve ratio.

The changes in the net asset classifications under the standard will create additional challenges when applying the financial responsibility ratios. However, the new accounting standard could also prompt the Education Department to take a fresh look at the ratios and its application of relevant US GAAP. While the Education Department recently issued a Notice of Proposed Rulemaking that includes changes to the financial responsibility regulations, these changes do not affect the ratios.[10] At this time, it is uncertain how or when the Education Department will revise the ratios to address the changes in the standard.

[8] Recalibrating Regulation of Colleges and Universities, Report of the Task Force on Federal Regulation of Higher Education.

[9] Report of the NAICU Financial Responsibility Task Force, November 2012.

[10] Education Department Notice of Proposed Rulemaking, June 16, 2016.

Other ratio analysis

Ratios used by other regulators and analysts are also based on the current net asset classification requirements. For example, expendable net assets, a key metric used to analyze liquidity, includes only the temporarily restricted portion of restricted net assets. This definition may be re-examined in the future but in the meantime, the differentiation between temporary and permanent is still important. While no longer required on the face of the financial statements, it will still be needed to calculate ratios. Because NFPs still need to track the historic dollar value and other components of donor-restricted endowments, we hope that most will continue to include this disaggregation in the disclosures, if not on the face of the financial statements, which will facilitate ratio calculations and comparisons with peers.

Other options considered

The FASB considered other net asset classification approaches, including distinguishing net assets not only based on donor restrictions but also based on legal, contractual or other restrictions. They also considered requiring NFPs to distinguish net assets by purpose (e.g. operations, net investment in plant or long-term investment). However, after research and outreach with constituents, the FASB decided to update, but not overhaul, the net asset classification requirements.

KPMG observation – Additional disaggregation on face of balance sheet is permitted

Some NFPs currently list categories (such as net investment in plant) within the unrestricted net assets class either on the face of the financial statements or in the disclosures. The standard continues to allow this practice within the net assets without donor restrictions class.

Similarly, while not required, some NFPs may opt to disaggregate within net assets with donor restrictions on the face of the balance sheet. Example 2.2 shows one presentation that an NFP may opt to show on the face of the balance sheet. Other NFPs may prefer to use a streamlined presentation on the face of the balance sheet and disaggregate within net asset classes only in the notes. The FASB decided not to prescribe the level of disaggregation on the face of the statements and permit NFPs to choose the presentation that best fits their organization and the users of their financial statements.

Example 2.2

Disaggregation of net assets on face of balance sheet

Net assets		
Without donor restrictions		
Net investment in plant	$	125,960
Designated by the board		610,000
Undesignated		55,250
Total net assets without donor restrictions		791,210
With donor restrictions		
Donor-restricted endowments		331,733
Perpetual trusts		80,260
Purpose restricted		27,120
Time restricted		3,567
Total net assets with donor restrictions		442,680
Total net assets	$	1,233,890

Disclosures

Donor-imposed restrictions

The standard retains the current US GAAP requirement for NFPs to disclose information about the nature and amounts of donor-imposed restrictions. These disclosures will now focus on both how and when, if ever, the net assets can be used rather than applying a bright-line distinction between temporary and permanent restrictions. [958-210-50-3]

The following example shows how an NFP may disclose this information.

Example 2.3
Net assets with donor restrictions disclosure

Net assets with donor restrictions

Net assets with donor restrictions are restricted for the following purposes and/or periods

Donor-restricted endowments subject to spending policy and appropriation, to support the following purposes (including net accumulated earnings of $53,445)	
Research	$ 150,547
Scholarships	40,040
Academic support	50,657
General activities	90,489
	331,733
Perpetual trusts, distributions available to support the following purposes	
Instruction	45,025
General activities	35,235
	80,260
Subject to expenditure for specified purposes	
Research	4,545
Scholarships	5,908
Instruction	3,422
Academic support	2,345
Capital projects	10,900
	27,120
Subject to passage of time	3,567
	$ 442,680

KPMG observation – Importance of net asset disclosures increases

Given the permitted streamlining on the face of the financial statements, the net asset disclosures may become more important to provide donors, creditors and other financial statements users with relevant information about NFPs' financial flexibility. The level of disaggregation (and its presentation on the face of the financial statements and/or the notes) of the nature of restrictions is left to NFPs' discretion.

Donor-restricted endowments

The standard has no requirement to differentiate between permanently and temporarily restricted net assets. However, NFPs may opt to provide information that allows users to make a similar distinction.

To illustrate, Example 2.3 discloses the total net accumulated earnings included in donor-restricted endowments. While not required, NFPs may consider disclosing these amounts (or the inverse, historic dollar value) either in a similar aggregated manner or in further disaggregated components (e.g. by purpose). While the illustrations in the standard include similar information, the FASB decided not to prescribe these disclosures to give NFPs the flexibility to decide what additional information would be useful.

Board designations

NFPs also must disclose information about the amounts and purposes of board designations of net assets without donor restrictions. Board designations are self-imposed limits due to actions of the governing board. This includes designations made by internal management in those instances where the governing board has delegated these decisions to management. [958-210-50-3, 958 Glossary]

Prior to the standard, US GAAP included specific disclosure requirements related to board-designated endowment funds (including a reconciliation of the beginning and ending balances). Some NFPs also opted to voluntarily disclose information about other types of board-designated net assets. Now the standard requires disclosure of the amounts and purposes for *all* board-designated net assets, including those designated for specific future expenditures, investment, contingencies, capital projects or other uses. [958-210-50-3, 958 Glossary]

NFP business-oriented HC entities – Internally designated funds

Under current US GAAP, NFP business-oriented HC entities report internally designated funds (for example, funds designated for capital) separately from externally designated funds either on the face of the balance sheet or in the notes to the financial statements. The form of the asset should be evident from the description on the balance sheet or in the notes. [954-210-45-4; 954-210-50-2].

This requirement does not change and should align with the requirement under the standard to disclose board-designated net assets.

Example 2.4

Board-designated net assets disclosure

Board-designated net assets

NFP's governing board has designated net assets without donor restrictions for the following purposes

Quasi-endowment, subject to spending policy and appropriation to support the following purposes	
Scholarships	$ 250,000
General activities	300,000
Liquidity reserve	50,000
Plant renewal fund	10,000
	$ 610,000

KPMG observation – Some disaggregation on the face may be combined with additional disaggregation in the disclosures

The examples above illustrate an NFP that opted to disaggregate within net asset classes to some extent on the face of the balance sheet (see Example 2.2). However, given the variety of purposes of donor-imposed restrictions and board designations, additional disaggregation in the notes (as shown in Examples 2.3 and 2.4) is necessary to fully comply with the standard's disclosure requirements.

Underwater endowments

The standard expands the disclosure requirements for underwater endowments. The following table shows the disclosure requirements under current US GAAP and those required under the standard for underwater endowments. [958-205-50-1B]

Disclosures for underwater endowments

Current US GAAP	Standard
Amount by which endowment funds are underwater (in the aggregate)	Amount by which endowment funds are underwater (in the aggregate)
	Original gift amount (or level required by donor stipulations or law) of underwater endowment funds (in the aggregate)
	Fair value of underwater endowment funds (in the aggregate)
	NFP's interpretation of its ability to spend and its policy, and actions it took during the period, concerning appropriation from underwater endowment funds.

KPMG observation – Disclosures about underwater endowments provide information on liquidity and financial flexibility

Some constituents have questioned whether disclosures about underwater endowments remain useful after UPMIFA de-emphasized the original gift amount and focused on total return. However, the FASB believes that these disclosures will help financial statement users analyze NFPs' liquidity and financial flexibility, particularly during a downturn in the financial markets.

While not required, NFPs may find it useful to include the quantitative underwater endowment disclosure in a table that provides similar information for the entire endowment. This may be included in the table displaying net asset classification and composition of endowment funds, as required by 958-205-50-1A. This combined and expanded disclosure may be more meaningful for financial statement users. Example 2.5 illustrates this disclosure.

Example 2.5
Endowment disclosure

	Without donor restrictions	With donor restrictions: Original gift	With donor restrictions: Accumulated gains (losses)	With donor restrictions: Total	Total funds as of June 30, 2016
Board-designated funds	$ 550,000			-	$ 550,000
Donor-restricted funds					
Underwater funds		$ 76,763	$ (19,767)	$ 56,996	56,996
Other funds		201,525	73,212	274,737	274,737
Total endowment funds	$ 550,000	$ 278,288	$ 53,445	$ 331,733	$ 881,733

Impact on statement of activities

Under the standard, there is no requirement to distinguish between the types of donor-imposed restrictions on current year contributions on the face of the statement of activities or in the disclosures.

KPMG observation – While not required, NFPs may opt to disaggregate contributions by type of restriction

Streamlining the net asset classes helps reduce reporting complexity. However, the combination of the two restricted net asset columns in the statement of activities also eliminates some information about the different types of donor-restricted contributions received during the period.

There is no requirement to distinguish between the different types of restrictions (e.g. a gift for the following period's operations versus a gift for a permanent endowment) in the financial statements. This gap is partially offset by the disclosures presented about the type of restrictions in the net asset balances at the end of the period.

NFPs may also voluntarily provide additional information about the types of restrictions imposed on the contributions received during the period, either on the face of the statement of activities or in the accompanying notes.

3 Reporting of expenses by function and nature

Under current US GAAP, all NFPs must present expenses by function (i.e. within categories of program services and supporting activities). Currently, only voluntary health and welfare entities must also present expenses by their nature (e.g. salaries, benefits, rent and depreciation). To achieve greater transparency, the FASB decided to require all NFPs to present expenses by function *and* nature.

KPMG observation – Information about expenses by nature will show how NFPs use their resources

The FASB decided that information about financial performance would be improved by providing greater transparency about how NFPs use their resources to carry out their mission. The FASB concluded that reporting expenses by their nature is useful in assessing an NFP's service efforts and its financial performance. Information about expenses by their nature also can be useful in distinguishing relatively fixed costs from variable or discretionary costs, which can be useful in assessing the NFP's sustainability.

Because substantially all NFPs track and manage their expenses by natural class, the cost to provide this information in the financial statements is expected to be minimal.

Expense analysis

The standard requires NFPs to report expenses by function and nature in *one* location (statement of activities, schedule in the notes or a separate financial statement). NFPs must show the relationship between the functional and natural classifications in an analysis that disaggregates functional expense classifications, such as major classes of program services and supporting activities, by their natural expense classifications. [958-720-45-15]

The following table includes guidance from the standard about whether to include or exclude certain items from the expense analysis. [958-720-45-15]

Include	Exclude
Direct donor benefits (e.g. facility rental costs) netted against special events revenue	Investment expenses netted against investment return
Expenses (e.g. salaries and benefits) included in cost of goods sold	Items typically excluded from net income of for-profit entities, e.g. those items included within other comprehensive income*
*Items included within other comprehensive income of for-profit entities are considered gains and losses and include foreign currency translation adjustments, pension and postretirement costs that are not recognized immediately as a component of net periodic benefit cost and other items. [220-10-45-10A]	

NFPs could present this expense analysis in a matrix; however, the standard prescribes no specific format.

KPMG observation – Matrix may be the most useful presentation

Currently some NFPs choose to report the required functional classifications of total expenses in the notes and to display total expenses by natural classification on the face of the financial statements (or the reverse). These NFPs, including some in the health care, higher education and trade association segments, believe that the natural classification provides more information to financial statement users than the functional classification.

However, this presentation would not fulfill the standard's requirement that expenses need to be presented by both natural and functional expense classification *in one location*. In response to questions raised by constituents, the FASB clarified that the expense analysis should show the relationship between the functional and natural classifications by disaggregating the functional categories by their natural classifications.

While the FASB does not prescribe a format, NFPs may find the matrix format currently used by voluntary health and welfare entities to be the most practical presentation to comply with the standard. However, the matrix could be included in a note to the financial statements rather than as a separate statement.

NFPs with less complex operations could also opt to disaggregate functional classifications into their natural classifications using a single column on the face of the statement of activities. However, this presentation would not include totals by natural class and therefore may not be the best option for NFPs that believe these totals are useful.

Example 3.1 illustrates the expense analysis in a matrix presentation, and Example 3.2 illustrates the expense analysis in a single-column presentation. The natural expense categories used are examples only as the FASB did not prescribe the level of disaggregation or the terms used to describe the categories.

Example 3.1
Expense analysis (matrix presentation)

	Program activities				Supporting activities			
	Program 1	Program 2	Program 3	Total program	Mgmt. & general	Fundraising	Total supporting	Total expenses
Salaries and wages	$ 2,125	$ 1,251	$ 4,253	$ 7,629	$ 750	$ 350	$ 1,100	$ 8,729
Employee benefits	650	352	1,200	2,202	202	100	302	2,504
Professional fees	525	252	1,025	1,802	180	90	270	2,072
Occupancy	621	309	1,300	2,230	2,032	1,256	3,288	5,518
Interest	250	125	520	895	90	50	140	1,035
Depreciation	411	202	850	1,463	152	76	228	1,691
Other	126	52	256	434	45	-	45	479
Total expenses	$ 4,708	$ 2,543	$ 9,404	$ 16,655	$ 3,451	$ 1,922	$ 5,373	$ 22,028

Example 3.2

Expense analysis (single column presentation)

Research	
Salaries and wages	$ 3,125
Employee benefits	1,000
Interest	250
Depreciation	301
Other	126
	4,802
Management and general	
Salaries and wages	560
Employee benefits	250
Interest	125
Depreciation	213
Other	217
	1,365
Total expenses	$ 6,167

Voluntary health and welfare entities – More flexibility is provided under the standard

Voluntary health and welfare entities currently must report expenses by function and nature through a statement of functional expenses. The standard gives these entities the same flexibility in presentation as other NFPs. This removes the current challenge to interpret the broad definition of *voluntary health and welfare entity* in the FASB Master Glossary, which has created diversity in how the current statement of functional expenses requirement is applied.

NFP business-oriented HC entities – Functional expense reporting is retained

During redeliberations, there was extensive discussion about whether NFP business-oriented HC entities (and potentially other business-like NFPs) should be exempted from the requirement to report expenses by function.

The FASB noted that the current functional reporting by some of these entities appeared perfunctory and provides little information about program services perhaps because these entities do not believe that the information is useful. However, the FASB ultimately decided to retain the requirement to report expenses by function for all NFPs, including HC entities.

The FASB said that it will explore in Phase 2 or in a future project whether NFP business-oriented HC entities should be required to provide disaggregated expense (and revenue) information by segments similar to what the SEC requires instead of expenses by functional classification.

Expense allocation disclosures

NFPs are currently required to allocate expenses that are attributable to more than one program or supporting activity. The standard retains this requirement, but expands the disclosure requirements to include a description of the methods used to allocate those expenses. [958-720-50-1(d)]

The current disclosure requirements for joint costs remain in effect but are expanded by the new expense allocation disclosures.

KPMG observation – Additional disclosures were prompted by concerns about diversity in NFP cost allocations

This disclosure requirement was prompted by concerns from some stakeholders that the lack of specific guidance on cost allocations has created diversity in functional expense ratios that are often used as a benchmarking tool to analyze NFPs.

The FASB discussed whether the additional disclosures should be quantitative, qualitative or both. Ultimately, the FASB decided to require only qualitative disclosures about the methods used to allocate expenses.

The standard does not prescribe the contents of this disclosure, but does include example disclosures on cost allocation methods used. Example 3.3 is taken from one of these examples.

Example 3.3

Qualitative disclosure about expense allocations

Note X. Methods Used for Allocation of Expenses from Management and General Activities

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the organization.

Expense	Allocation basis
Depreciation and amortization	Square footage
President's office	Estimates of time and effort
Communications department	Estimates of time and effort
IT department	Estimates of time and costs of specific technology utilized

[958-720-55-176]

Management and general activities

In an effort to increase clarity and promote further consistency and comparability among NFPs, the FASB also focused on management and general activities. Current guidance provides activities that comprise management and general activities such as oversight, general recordkeeping and disseminating information to inform the public of the NFP’s stewardship of contributed funds. This list also includes “all other management and administration except for direct conduct of program services…, fundraising activities…, or membership development activities.” However, this phrase has led to diversity about what costs are allocated to other program or supporting functions versus remaining in management and general costs. [958-720-45-7]

The table below highlights the clarifications included in the standard to help alleviate the diversity among NFPs.

	Revised definition	Additional examples
Management and general	“Supporting activities that are not directly identifiable with one or more program, fundraising, or membership-development activities.” [958 Glossary]	— Employee benefits management and oversight (human resources) — Payroll [958-720-45-7]
	Clarification	**Illustrations**
Direct conduct or direct supervision of program or other supporting activities	These require allocation from management and general activities to the activities that benefit [958-720-45-2A]	— CEO (Example 3.4) — CFO — Human resources (Example 3.5) — Grant accounting and reporting [958-720-55-171 – 175]

Example 3.4
Chief executive officer allocation

The broad responsibilities of a chief executive officer (CEO) generally include administrative and program oversight. At Not-for-Profit A, the CEO spends a portion of time directly overseeing the research program. Additionally, a portion of time is spent with current and potential donors on fundraising cultivation activities. Some of the CEO's compensation and benefits and other expenses would be allocated to the research program and to the fundraising function representing the portion of time spent on those activities because they reflect direct conduct or direct supervision.

If the remainder of the CEO's time is spent indirectly supervising other areas of Not-for-Profit A, including the administrative areas, those activities would not constitute direct conduct or supervision, and the ratable portion of compensation and benefit amounts would remain in management and general activities. [958-720-55-172]

Example 3.5
Human resources department allocation

The human resources department at Not-for-Profit C generally is involved in the benefits administration for all personnel. The human resources department's related costs would not be allocated to any specific program. Rather, those costs would remain a component of management and general activities because benefits administration is a supporting activity for the entire organization. [958-720-55-174]

KPMG observation – Additional implementation guidance may prompt NFPs to re-evaluate expense allocations

These clarifications could result in a change in practice for some NFPs that currently interpret *direct conduct and direct supervision* or the definition of *program services* more broadly than the guidance in the standard would support. The added requirement to disclose the methods used to allocate costs also may prompt some NFPs to take a fresh look at how they allocate expenses.

Higher education – Inconsistencies in expense allocations

NACUBO and others have said that there is inconsistency within higher education with respect to how expenses are reported by function. Some colleges and universities have focused more on natural classification, and the functional classification has historically received less attention.

However, there has been additional focus by external parties, including media outlets, public officials and other stakeholders with an interest in comparing the cost of obtaining a degree at different institutions or evaluating the institution's effectiveness at conducting research or other programs. This has caused some in the higher education community to recognize the increased importance of the functional classifications. This environment, combined with the requirements to present expenses by both function and nature and disclose expense allocation methods, may prompt higher education institutions to take a fresh look at their functional allocations.

4 Presentation of investment expenses and return

The standard amends the presentation of investment expenses and return for non-programmatic investing. The standard requires NFPs to net investment expenses against investment return, but no longer requires disclosure of the amount of investment expenses or the components of gross investment return.

The changes to the reporting of investment expenses and return do not relate to programmatic investing. Programmatic investing is the activity of making loans or other investments directed at carrying out the NFP's purpose rather than investing in the general production of income or appreciation of an asset (e.g. total return investing). An example of programmatic investing is a loan made to lower-income individuals to promote home ownership. [958 Glossary]

Investment expenses

Current US GAAP	Standard
Two options: — Report investment expenses net (against investment return), or — Report investment expenses gross (in expenses)	Report investment expenses net (against investment return) [958-225-45-14]
Netted expenses limited to *related* expenses incurred during the period	Netted investment expenses limited to *external* and *direct internal* investment expenses incurred during the period: — Direct internal investment expenses involve the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return [958-225-45-14 – 14A]
If investment expenses are netted, disclose this amount	No disclosure of investment expenses required
Include netted investment expenses in the statement of functional expenses (if presented)	Exclude netted investment expenses from the expense analysis [958-720-45-15]

KPMG observation – Net reporting provides a more comparable measure

While many NFPs currently elect the option to net investment expenses against the associated return, the current requirement to disclose the total amount of netted investment expenses presents challenges, particularly with embedded fees. Examples of embedded fees include those charged by hedge funds, mutual funds and funds of funds. These fees often are difficult to identify and accumulate on a timely basis for financial reporting purposes. Therefore, the investment expenses currently disclosed by NFPs often are not all-inclusive and may only reflect readily accessible expenses.

The AICPA's Financial Reporting Executive Committee and other constituents asked the FASB to reconsider the reporting requirements for investment expenses. The FASB concluded that the cost and effort to obtain the information seemed to exceed the benefit that the investment expense information provided to financial statement users. Most users find the net investment return to be more relevant, comparable and useful.

Therefore, the FASB decided to eliminate the requirement to disclose total investment expenses. The FASB also decided to remove the option to present investment expenses gross, within expenses, to improve comparability among NFPs. Net reporting also provides a more comparable measure irrespective of whether internal staff or external advisors manage investment activities.

Related versus external and direct internal

Current FASB guidance permits *related* investment expenses to be netted. However, the FASB concluded that the netted investment expenses should be limited to *external* investment expenses and *direct internal* investment expenses. NFPs would not be required, or permitted, to net *indirect internal investment* expenses against investment return. To clarify questions raised about this distinction, the FASB included implementation guidance to illustrate what activities constitute *direct* internal investing activities. This may result in changes for some NFPs that currently net accounting and other administrative investment costs against investment return.

Include	Exclude
— Costs associated with the officer and staff responsible for the development and execution of investment strategy — Costs associated with internal investment management and supervising, selecting and monitoring of external investment firms [958-225-45-14A]	— Costs that are *not* associated with generating investment return. For example, the costs associated with unitization and other aspects of endowment management [958-225-45-14B]

Gross investment return

NFPs will no longer be required to disclose gross investment return or its disaggregated components. The difficulties related to disclosing investment fees, which are often embedded in the investment return, also complicate the process of disclosing gross investment return. Therefore, the FASB decided to remove the following disclosure requirements from US GAAP for NFPs.

- Components of gross investment return;
- Components of gross investment return relating to the endowment portfolio within the required endowment reconciliation disclosure; and
- Portion of unrealized gains or losses for the period that relates to equity securities held at the end of the reporting period. (This disclosure requirement was added to US GAAP under ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*, which is effective for fiscal years beginning after December 15, 2018. The FASB added the exemption for NFPs in 321-10-50-2A.)

KPMG observation – Presentation of investment return aligns with total return concept in UPMIFA

The changes to the presentation of investment return and expenses are more in line with the total return concept inherent in UPMIFA and investment analysis in the current environment.

Private foundations – Excise tax

Private foundations are subject to a one or two percent excise tax on net investment income, as defined by the Internal Revenue Code. This excludes unrealized gains and losses. Therefore, private foundations will still need to track, and may choose to continue reporting in the financial statements, the components of gross investment return.

Institutions of higher education – Other investment portfolio

The standard eliminates the requirement to disclose the total performance of the other investment portfolio. While practice varies, institutions of higher education are currently required to separately present the total performance (investment income and realized and unrealized gains and losses) of the other investment portfolio in the statement of activities or accompanying notes. Other investments are defined in FASB's investment guidance for not-for-profit entities.[11] Those investments include certain investments in real estate, mortgage notes that are not debt securities and oil and gas interests. The FASB decided to eliminate this disclosure requirement consistent with its other changes.

Presentation on the statement of activities

The standard permits NFPs to present net investment return from portfolios that are managed differently or derived from different sources in separate lines within the statement of activities if they are appropriately labeled. For example, NFPs may distinguish investment return on short-term investments from the return on the endowment portfolio. Similarly, NFPs that present a measure of operations may present the amount of net investment return appropriated for spending separately from net investment return in excess of amounts appropriated for spending. [958-225-45-14]

[11] FASB ASC Subtopic 958-325, Not-for-Profit Entities – Investments-Other, available at www.fasb.org.

NFP business-oriented HC entities – Investment return

Under current US GAAP, NFP business-oriented HC entities are required to present on the statement of operations unrealized gains or losses attributable to other-than-trading securities and investment return restricted by donors or by law outside the performance indicator. The standard did not change this requirement. [954-225-45-7]

To comply with this requirement, NFP business-oriented HC entities will continue to disaggregate these components of investment return and present them outside the performance indicator. The standard does not prescribe how this information should be displayed but does include two possible presentations of how NFP business-oriented HC entities may disaggregate investment return within the change in net assets without donor restrictions. [954-225-55-6]

Example 4.1 illustrates a third presentation option for an NFP business-oriented HC entity that displays an intermediate measure of operations in addition to the performance indicator.

Example 4.1

Investment return disaggregated for performance indicator

Operating revenues	
Net patient service revenues	$ 851,458
Provision for uncollectible accounts	(69,303)
Net patient service revenues less provision for uncollectible accounts	782,155
Other revenues	32,757
Total operating revenues	814,912
Operating expenses	753,456
Operating excess	61,456
Nonoperating gains and losses	
Investment return, net, excluding unrealized gains on other than trading securities	84,651
Revenues and gains in excess of expenses and losses	146,107
Unrealized gains on other than trading securities	13,777
Increase in net assets without donor restrictions	$ 159,884

5 Liquidity and availability disclosures

The standard retains the existing liquidity disclosure and presentation requirements for HC and other NFPs. However, it requires all NFPs to provide additional information about liquidity and availability of financial resources. [958-210-50-1A]

Liquidity information	Availability information
Qualitative information in the notes about how an NFP manages its liquid resources that are 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 needed, about the availability of an NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date. — Availability of a financial asset may be affected by its nature; external limits imposed by donors, laws and contracts with others; or internal limits imposed by governing board decisions. — *Financial asset* is defined as "cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to … a. receive cash or another financial instrument from a second entity [or] b. exchange other financial instruments on potentially favorable terms with the second entity." [Master Glossary]

KPMG observation – Considerations for disclosures about liquidity and availability of financial assets

One of the major objectives of the FASB's project was to improve the quality of information users have to assess liquidity and how NFPs manage their exposure to liquidity risk. NFP business-oriented HC entities must classify assets and liabilities as current or noncurrent on the balance sheet and separately present assets whose use is limited on the face of the balance sheet or in the notes.

Other NFPs must provide information about liquidity of assets and liabilities through:

- sequencing these items based on liquidity;
- classifying these items as current or noncurrent; or
- providing disclosures about the liquidity or maturity of such items, including restrictions on use.

However, some have observed that it is often still difficult to assess liquidity because assets may appear to be liquid based on their nature, but restrictions imposed by contracts, laws or donor stipulations may affect liquidity and result in these assets being unavailable to meet short-term cash requirements.

The FASB considered various alternatives, including requiring a classified balance sheet or separate presentation of assets whose use is limited by all NFPs (as is currently required for NFP business-oriented HC entities). The FASB ultimately decided to require additional quantitative and qualitative disclosures. The disclosures included in the proposed standard focused on financial assets available and financial liabilities due with a self-defined time horizon. However, the FASB subsequently revised these disclosures to exclude financial liabilities, define the time horizon as one year from the balance sheet date, and better distinguish the disclosures related to liquidity from those related to availability.

Liquidity

When preparing the qualitative disclosure on liquidity, consider these items.

- How does the NFP manage cash in excess of daily requirements?
- Is there a liquidity reserve? What is the balance?
- Are there board-designated funds that may be used if needed?
- Are there available lines of credit?

Availability

When preparing the quantitative disclosure on availability, the balance sheet would be the best starting point. The financial assets in the disclosure should be a subset of, and reconcilable to, total assets on the balance sheet. Designations and restrictions included in the NFP's net assets will need to be parsed to determine which financial assets are available. Qualitative disclosures often will be needed to clarify the quantitative information for the reader and put the amounts in context. For example, if an NFP is heavily funded by restricted resources, the disclosed amount of total financial assets *available* may imply that the NFP is in financial constraints, even if this is not the case. NFPs may include additional qualitative information to better explain the availability of financial resources. This may be combined, where appropriate, with the NFP's disclosures on liquidity.

These disclosures may be the most time-intensive for NFPs to understand and implement.

The standard includes examples illustrating different ways NFPs might fulfill the liquidity and availability disclosure requirements. Example 5.1 gives one example from the standard and illustrates the quantitative portion of the availability disclosure.

Example 5.1

Availability quantitative disclosure

Financial assets, at year-end	$ 234,410
Less those unavailable for general expenditure 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

[958-205-55-21 Note G]

6 Statement of cash flows

NFPs retain the option to present operating cash flows using either the direct or indirect method under the standard. NFPs that opt to use the direct method will no longer need to include a reconciliation of the change in net assets to cash flows from operating activities. [230-10-45-28 – 45-29]

KPMG observation – Direct method is not required but may be considered more useful

The FASB initially proposed eliminating the option to present operating cash flows using the indirect method and requiring all NFPs to use the direct method. While most entities (NFPs and for-profit businesses) use the indirect method, the FASB found that the indirect method often is not well understood and less useful in assessing financial performance and liquidity compared with the direct method.

The FASB performed outreach with NFPs and similar entities that currently use the direct method of reporting operating cash flows. This included public universities that follow GASB standards, which require the direct method of reporting operating cash flows, as well as some private universities and other NFPs that have voluntarily elected to do the same. These entities generally reported that their governing board members and other stakeholders found the information in the direct method to be clearer and more insightful. They generally reported minimal additional costs, which mostly related to first-year implementation costs to train personnel and map information from existing systems.

Many entities that report using the direct method determine the operating cash receipts and payments indirectly (i.e. by adjusting revenue and expense amounts for the change during the period in the related asset and liability accounts). This method, which is discussed in the Basis for Conclusions of Statement 95, is considered a more cost-effective method for entities that do not have the ability to track gross operating cash receipts and payments directly from their accounting systems.[12]

However, while acknowledging the benefits of the direct method to users of the financial statements, many questioned the necessity of requiring this method for NFPs while business entities have more flexibility. Therefore, the FASB decided to allow NFPs to retain the option to use either method.

For NFPs that opt to present operating cash flows using the direct method, the reconciliation of the change in net assets to net cash flows from operating activities (indirect reconciliation) will no longer be required. This requirement may have been a deterrent to using the direct method and its removal may now incentivize NFPs to switch to the direct method.

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[12] FASB Statement No. 95, Statement of Cash Flows (subsequently codified in Topic 230), available at www.fasb.org.

7 Intermediate measure of operations

NFPs that present a self-defined intermediate measure of operations on the statement of activities may be required to provide additional disclosures. If the NFP presents internal board designations, appropriations and similar actions on the face of the financial statements, these actions must be appropriately disaggregated and described by type on the face of the financial statements or in the notes. [958-225-45-12]

KPMG observation – Transparency of internal board actions is explicitly prescribed

While the decision on whether NFPs should be required to present a defined intermediate measure of operations was deferred to Phase 2 of this project, Phase 1 included consideration of expanded disclosures. The consideration was prompted by feedback during the project about the types of intermediate operating measures being used and the perception that some NFPs were providing less than adequate disclosure.

Current US GAAP requires that if an NFP's use of the term *operations* is not apparent from the details provided on the face of the statement of activities, a note to the financial statements should describe the nature of the reported measure of operations or the items excluded from operations. In the FASB staff's study of current practice, it identified several problems and opportunities for improvements. They included insufficient disclosures and a lack of transparency of governing board designations, appropriations and similar actions that affect the measure of operations.

Based on its review of financial statements, the FASB noted that board actions are often aggregated, or vaguely described, in the financial statements. The review also showed that some of the board actions resulted in significant financial consequences that seemed to warrant separate line items or a note disclosure. The FASB therefore decided to add an explicit requirement to report these board actions appropriately disaggregated and described by type, either on the face of the financial statements or in the notes.

While the standard does not prescribe the form of presentation, it does include two examples that help illustrate where the information on the statement of activities is transparent versus where disclosures are necessary. Example 7.2 illustrates the board appropriations and designations disaggregated and captioned on the face of the statement of activities. Example 7.3 illustrates the option where the items are aggregated in a single 'transfer of funds' line on the statement of activities. This presentation on the statement of activities would need to be accompanied by a disclosure in the notes where the transfers are disaggregated and described by type using the same level of detail as in Example 7.2.

These examples are just two possible presentations suggested by the FASB and are perhaps the extremes of possible presentations on the face of the statement of activities. NFPs may also opt for a presentation where the information on the face of the statement falls between the levels illustrated in the two examples accompanied by additional disclosures in the notes. For example, there is no requirement to show total contributions in operating revenues with deductions of the non-operating contributions in the operating section. An NFP may opt to include the portion of contributions that are defined as operating in the operating section of the statement of activities, and those defined as non-operating in the non-operating section, if the designation is clearly described on the face of the statement or in the notes.

Alignment with board-designated net assets disclosure

The current period governing board actions should align with the disclosure of board-designated net assets without donor restrictions at period end. For example, if a current year bequest is included in non-operating activities on the statement of activities due to a board action to create a board-designated endowment fund, the balance at period-end would also be disclosed. This information may be combined in the same note disclosure.

On the other hand, if an NFP decides to appropriate a portion of net assets without donor restrictions to create a board-designated endowment fund from operating surpluses accumulated in prior periods, we would not expect the NFP to present the appropriation on the current year's statement of activities. However, the balance in the board-designated endowment fund at period-end would be disclosed.

Example 7.2
Board actions disaggregated

	Without donor restrictions	With donor restrictions	Total
Operating revenues, gains and other support:			
Contributions	$ X,XXX	$ X,XXX	$ X,XXX
Less:			
Contributions designated by board for capital projects	(3,000)		(3,000)
Contributions and bequests designated by board for quasi-endowment	(5,000)		(5,000)
Investment returns appropriated from quasi-endowment	1,025		1,025
Programmatic investing return	XX		XX
Other	XXX		XXX
Net assets released from restrictions			
Investment return appropriated and released for current operations from donor-restricted endowment	X,XXX	(X,XXX)	
[Other net assets released from restrictions]	X,XXX	(X,XXX)	
Total operating revenues, gains and other support	XX,XXX	X,XXX	XX,XXX
Operating expenses:			
Program A	XX,XXX		
Program B	X,XXX		
Program C	X,XXX		
Management and general	X,XXX		
Fundraising	X,XXX		
Total operating expenses	XX,XXX		XX,XXX
Operating revenues and support in excess of operating expenses	XX,XXX	X,XXX	X,XXX
Investment return, net	X,XXX	XX,XXX	XX,XXX
[Other items considered to be nonoperating]	X,XXX	X,XXX	X,XXX
Investment returns appropriated for current operations from quasi-endowment	(1,025)		(1,025)
Contributions designated by board for capital projects	3,000		3,000
Contributions and bequests designated by board for quasi-endowment	5,000		5,000
Loss on extinguishment of debt	(X,XXX)		(X,XXX)
Change in fair value of interest rate swap	X,XXX		X,XXX
Change in net assets	$ XX,XXX	$ X,XXX	$ XX,XXX

[958-225-55-17]

Example 7.3
Board actions aggregated

	Without donor restrictions	With donor restrictions	Total
Operating revenues, gains and other support			
Contributions	$ X,XXX	$ X,XXX	$ XX,XXX
Fees	X,XXX		X,XXX
Programmatic investing return	XX		XX
Other	XXX		XXX
Net assets released from restrictions			
Investment return appropriated and released for current operations from donor-restricted endowment	X,XXX	(X,XXX)	
[Other net assets released from restrictions]	X,XXX	(X,XXX)	
Total operating revenues, gains and other support	XX,XXX	X,XXX	XX,XXX
Operating expenses:			
Program A	XX,XXX		
Program B	X,XXX		
Program C	X,XXX		
Management and general	X,XXX		
Fundraising	X,XXX		
Total operating expenses	XX,XXX		XX,XXX
Net transfer of funds from operations	(6,975)		(6,975)
Operating revenues in excess of operating expenses and transfers	XX,XXX	X,XXX	XX,XXX
Other changes:			
Investment return, net	X,XXX	X,XXX	X,XXX
Contributions	X,XXX		X,XXX
Other	X,XXX		X,XXX
Net transfer of funds to operations	6,975		6,975
Change in net assets	$ XX,XXX	$ X,XXX	$ XX,XXX

[958-225-55-18]

8 Expiration of restrictions on long-lived assets

NFPs (other than business-oriented HC entities) currently have an option of electing a policy of implying a time restriction on donated long-lived assets. Under such a policy, the time restriction on the associated net assets expires over the useful life of the donated long-lived asset. Some NFPs currently elect this policy because it allows the release of the net assets to be matched by the asset's depreciation expense.

The standard eliminates this option. This applies to both purpose-restricted contributions of long-lived assets and contributions of cash restricted for the acquisition or construction of long-lived assets. All restrictions on long-lived assets must now be released when the assets are placed in service, unless there are explicit donor restrictions indicating otherwise. There may be circumstances where the donor restriction could extend beyond the point that the asset is placed in service. For example, if the donor specifies that the asset must be used for a specified period of time, the restriction would expire over the specified period of time. [958-360-45-1A]

NFP business-oriented HC entities – This change has no effect

NFP business-oriented HC entities are already required to use the placed-in-service approach.

KPMG observation – Release of restrictions as cash is expended was considered but rejected by the FASB

The FASB also considered the alternative of releasing the restrictions on contributions of cash restricted for the construction of long-lived assets as the cash is expended. This alternative was suggested by some constituents as a more practical presentation that would also be more consistent with the release of other types of restrictions.

However, the FASB rejected this approach. "The Board concluded that the placed-in-service approach best reflects economic reality in that generally donors want to subsidize the acquisition of long-lived assets so that the assets can be put to use in conducting and often expanding an NFP's programs and that their intent and restrictions are met if the qualifying assets are purchased *and* placed in service." [ASU 2016-14.BC73]

9 Equity transfers

Equity transfers (i.e. between a parent and subsidiary or entities under common control in stand-alone financial statements) must be reported separately as changes in net assets on the statement of activities by all NFPs. [958-225-45-17A, Master Glossary]

The standard does not explicitly require NFPs to label equity transfers using this term, and still permits other terms (e.g. grant from affiliate).

NFP business-oriented HC entities – No change to presentation

NFP business-oriented HC entities will continue to report equity transfers as a separate line outside the performance indicator.

KPMG observation – Equity transfers are not included in the expense analysis

While the standard states that equity transfers should be reported separately on the statement of activities, it does not specify whether outgoing equity transfers should be included in (or excluded from) the expense analysis. However, the standard does state that items typically excluded from net income of for-profit entities should not be included in the expense analysis.

As stated in the FASB's Master Glossary, equity transfers are similar to ownership transactions between a for-profit parent and its owned subsidiary (e.g. additional paid-in capital or dividends). These transactions are not included in net income of a for-profit entity. Therefore, we believe that equity transfers should not be considered expenses for purposes of the statement of activities and should also be excluded from the expense analysis.

10 Effective date and transition

Question	Answer
When does the standard become effective?	Annual periods in fiscal years beginning after December 15, 2017
	Interim periods in fiscal years beginning after December 15, 2018
May NFPs early adopt?	Yes, all NFPs may adopt the standard immediately.
How should transition be reflected in the financial statements?	Retrospective, with elective reliefs, in the year of adoption.
	Disclose the nature of reclassifications or restatements and their effects, if any, on changes in the net assets for each period presented.
What are the elective reliefs?	NFPs that present comparative financial statements may omit certain information for periods presented before the period of adoption: — Analysis of expenses by function and nature* (must still present expenses by function and by nature); and — Additional disclosures about liquidity and availability of resources. *Except voluntary health and welfare entities, which are currently required to provide this analysis.

Question	Answer
May NFPs partially adopt the standard?	NFPs must adopt in the same year all of the standard's provisions that change or remove current US GAAP (e.g. provisions that combine the restricted net asset classes, change the accounting for underwater endowments or eliminate disclosures).
	NFPs may adopt any particular provisions that are additive and do not conflict with current US GAAP (e.g. liquidity and availability disclosures or reporting expenses by function and nature) prior to formally adopting the standard.

KPMG observation – Implementation considerations

Reclassifications between net asset categories may be needed

While it may be tempting to think of the change to net assets as a simple combination of temporarily and permanently restricted net assets, some changes may cause NFPs to reclassify amounts between net asset classes. For example, eliminating the option to release restrictions over an asset's estimated useful life would require NFPs currently using this option to immediately release any remaining restricted net assets relating to those assets that have already been placed in service, unless explicit donor restrictions indicate otherwise.

The change in the classification of donor-restricted endowment deficiencies from the unrestricted net assets category to the net assets with donor restrictions category also would result in an immediate reclassification of net assets upon implementation for those NFPs with underwater endowments.

NFPs would apply the changes retrospectively to the net assets at the beginning of the earliest year presented.

Elective relief applies to expense analysis but NFPs must still present expenses by function and nature

In the year of adoption, NFPs (other than voluntary health and welfare entities) may omit the analysis of expenses by function and nature for periods presented before the year of adoption. However, they must still present expenses by both function and nature for the prior periods. This is not required to be in the same location and does not need to include disaggregation of functional expenses by their natural categories. For example, NFPs could present expenses by function on the face of the statement of activities and expenses by nature in the notes, either separately or as an additional prior year total column in the current year analysis.

11 Keeping you informed

Where can you learn about the latest financial reporting changes?

The Financial Reporting Network (FRN) provides a single source for the latest, executive-level financial reporting information, as well as news and activity from standard setters and industry sources – all organized by topic.

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