Enhancing Transparency

New Liquidity Disclosures for Not-for-Profits

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In August 2016, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. The new standards are expected to improve the usefulness of information provided to donors, grantors, creditors, and other users of the not-for-profit entity's (NFP) financial statements. The key changes resulting from FASB's ASU 2016-14 are included below[1].

- **Net Asset Classifications.** Previously there were three net assets classes, which included unrestricted, temporarily restricted, and permanently restricted. Now there are only two classes, assets without donor restrictions and net assets with donor restrictions.
- **Underwater Endowments.** NFPs are to report the current fair value of the fund, original gift amount, and amount of deficiency for endowments with losses. Additionally, any endowments designated by the governing board are to be reported as net assets without donor restrictions.
- **Donations of Property and Equipment.** Donor restrictions should be released when assets are placed in service, unless stipulated by the donor.
- **Transparency and Utility of Liquidity.** The new requirements related to liquidity are discussed further in detail below.

- **Expenses Classified by Function and Nature.** NFPs are required to report expenses by natural expense category, either on the face of the statement of activities or in a disclosure.
- **Statement of Cash Flows.** NFPs are no longer required to include the indirect reconciliation from the change in net assets when the direct method is used.

This article will focus on the ASU's new liquidity disclosure requirements. NFPs are to disclose in notes to financial statements relevant information about the liquidity or maturity of assets and liabilities, including restrictions and self-imposed limits. These disclosures are in addition to the information provided on the face of the statement of financial position.

LIQUIDITY DISCLOSURE REQUIREMENTS

- **Quantitative Information.** NFPs are required to provide quantitative information, either on the face of the statement of financial position or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of the NFP's financial assets to meet cash needs for general expenditures within one year of the date of the statement of financial position. Availability of a financial asset may be affected by its nature; external limits imposed by donors, laws, and contracts with others; and internal limits imposed by governing board decisions.
- **Qualitative Information.** NFPs are required to provide information that communicates how it manages its liquid resources available to meet cash needs for general expenditures

within one year of the date of the statement of financial position. This provides NFPs an opportunity to tell their story while revealing their strategies for managing financial resources.

NFPs — BE PROACTIVE

ASU 2016-14 is effective for periods beginning after Dec. 15, 2017. Therefore, the new disclosure requirements will currently affect NFPs with a 2018 calendar year-end, while it may not affect other NFPs until 2019 fiscal year-ends. If you haven't initiated the planning process, now is a great time to start. NFPs with a 2018 calendar year-end, can begin drafting the new liquidity note disclosures earlier in the financial statement preparation process. While NFP's with a fiscal year end 2019, can begin planning now for the implementation of the new liquidity disclosures. These are steps that NFPs can take now to create exceptional liquidity disclosures[2].

- **Evaluate whether any changes to accounting and reporting systems are necessary to easily capture the information to be disclosed.** Assess whether the current supporting systems, technology and existing chart of accounts are sufficient to capture the data required by the new disclosures.
- **Review the current policies and procedures around board designation of net assets.** Assess if your current procedures for identifying and designating net assets still make sense or if the procedures need to be changed. Assess if your organization's policy on board designation needs to be updated or if an informal policy needs to be documented. Consider the need for a new policy to formalize and support the new liquidity disclosures.
- **Determine the message the NFP wants to convey to its stakeholders.** For example, if your organization has more than enough resources to fund activities over the next 12 months, make that clear in the disclosure. Perhaps, you may include your policy for managing excess revenues. If you have significant capital projects, you may want to include a discussion on the resources that have been set aside to fund them and when they are used. Or, if it is difficult for your organization to maintain sufficient resources to cover general expenses, you may want to disclose your plan for covering those expenditures.
- **Decide on the best presentation approach for your organization.** The format of the new liquidity disclosures will vary, depending on the type of NFP. The ASU provides a few examples.
- **Prepare the quantitative liquidity information at a recent reporting date.** This can be a valuable exercise for the NFP, by using this information as a starting point for discussions about liquidity with the finance committee. The quantitative information is particularly critical since the fungibility of cash causes numerous NFPs to spend cash restricted by donors, especially small and medium-sized NFPs. Once management and the board of directors have reviewed the effect of the quantitative information on the NFP, further considerations can be made such as removing designations for certain assets and/or adopting a formal liquidity management policy[3].

AUDITORS — ENHANCE YOUR VALUE TO NFPs

Auditors are constantly searching for new ways to enhance the value of their services to clients. The implementation ▶

of ASU 2016-14 provides an opportunity for auditors to do just that. However, auditors should be careful not to impair their independence when providing NFPs with guidance, especially with small and mid-sized NFPs as they may require greater assistance with the implementation process.

Below are a few ways auditors can assist NFPs with the new standard:

- **Provide education.** Educate them on the upcoming changes and the decisions that need to be made prior to the implementation. This can be done through direct discussions with the NFP's management team and governing board, providing local webinars, live seminar to a group of NFPs in a community, or a combination of both.
- **Provide illustrative examples.** Auditors can provide examples of financial statements that have implemented the new liquidity disclosure requirements. By providing examples of the quantitative information and language included within the notes of financial statements, auditors help clients to better understand the impact of the new liquidity disclosure requirements and how it can be implemented.
- **Early Planning.** Implementing ASU 2016-14, both efficiently and effectively, can require significant hours and can perhaps be a bit overwhelming for some NFPs. Ask your clients, that are NFPs, if they would like to schedule one or two meetings prior to their year-end to discuss the required changes. This will give the NFP's management team additional face-to-face time with their auditor, to ask any questions or concerns they may have about implementing the new standard in the NFP's financial statements. This can be very helpful to NFPs as they move forward and transition into the new standard.
- **Early Implementation.** Ask a couple of your NFPs if they would like to implement the required disclosures early. This provides the auditors with an opportunity to review the NFP's new liquidity disclosures and recommend any changes ahead of time. It would also help the audit firms to work with the NFPs in stages, instead of all at once.

CONCLUSION

NFP's should become very familiar with FASB's ASU 2016-14 to understand the effect of the new reporting requirements on their financial statements. NFPs should assess if their current systems, technology, policies and procedures are sufficient to be able to meet the new reporting requirements. The earlier NFPs start preparing for the required changes, the more time it will allow stakeholders to make recommendations. Auditors can be valuable to NFPs, during the transition, by providing education and illustrative examples how to implement the new reporting requirement. Although the new reporting requirements may seem a bit overwhelming, it is a great opportunity for NFPs to tell their story.

[1] 6 Key Changes for Nonprofits in the FASB's ASU 2016-14, by Louis Stratton, npENGAGE

[2] Steps You Can Take Now to Create Exceptional Liquidity Disclosures (AICPA) *January 2016*

[3] "NFP New Standard Implementation Series – Tips for Adopting ASU 2016-14: NFP Reporting Model" by Tondeé Lutterman, BKD CPAs & Advisors, *November 2017*

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