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BLOG POST

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FASB Proposes Significant Changes to Nonprofit Accounting Standards

The Financial Accounting Standards Board ("FASB") recently issued a **Proposed Accounting Standards Update** ("ASU") specific to Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954). The ASU seeks to improve net asset classification reporting requirements, as well as require expanded information on liquidity, financial performance, and cash flow. The full scope of proposed changes is too extensive to address here. We highlight three categories of changes that could have a significant impact on the way nonprofits report (and think about) their finances.

Revised Net Asset Classifications

FASB's current standards require that net assets be divided into three categories:

1. **Permanently restricted assets**, meaning assets whose use is limited by donor-imposed stipulations that will not expire by passage of time and cannot be fulfilled or removed by the organization. Endowments are the classic example of permanently restricted assets.
2. **Temporarily restricted assets**, meaning assets whose use is limited by donor-imposed stipulations that may expire by passage of time or can be fulfilled or removed by the organization. Funds that are restricted to a particular purpose are an example, as once the organization spends the funds for the purpose, it has fulfilled the restriction.
3. **Unrestricted assets**, meaning assets that are neither permanently nor temporarily restricted.

The ASU proposes replacing these categories with two classifications only:

1. **Assets *with* donor restrictions**, which would include both permanently and temporarily restricted assets; and
2. **Assets *without* donor restrictions**, which include unrestricted assets and assets restricted internally by Board designation.

FASB asserts that eliminating the distinction between resources with permanent restrictions and those with temporary restrictions will reduce complexity, while requiring enhanced disclosures in the notes (explained below) will allow nonprofits to detail the types and effects of the different donor-imposed restrictions. FASB also notes that "[t]he currently required distinction … has become blurred by changes in state laws that diminished its relevance and rendered that distinction less useful …." (see the discussion of UPMIFA below).

Enhanced Expense Disclosures

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Nonprofit Law Matters looks at legal issues in the nonprofit and tax-exempt organizations world. Written by the attorneys and paralegals of Adler & Colvin, it provides updates and analysis regarding philanthropy, charity, and other exempt organization issues.

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The ASU provides several opportunities for nonprofits to report more effectively on their expenses.

- The ASU would require organizations to report functional expenses by **both nature** (salaries, grants, occupancy, etc.) and **function** (program, fundraising, management, etc.). Although many nonprofits already do this, current rules allow reporting by **either nature** or **function** or both.
- The ASU would require enhanced disclosures as to the method(s) used to allocate costs among "program" and "support" on the **statement of functional expenses.** Currently, nonprofits have no clear and consistent guidance about how to allocate costs among program and support functions. The Form 990 Instructions, for example, indicate that "the organization can use any reasonable method of allocation." The new disclosures would presumably increase transparency and promote consistency in classification methods across organizations.

Given that many charity "watchdog" and rating services, like Charity Navigator or the Better Business Bureau, measure nonprofits' success based on their functional expense reporting, these enhanced disclosure requirements may shed light on why one organization's reported expenses differ from another's.

Underwater Endowment Disclosures

An endowment is "underwater" when the fair value of the fund has fallen below the original, permanently restricted gift amount. The Uniform Prudent Management of Institutional Funds Act (UPMIFA), which has been adopted in almost every state, now permits a charity to appropriate for expenditure so much of an endowment fund as the charity determines is prudent for the purposes for which the fund was established, taking into account certain factors. Under UPMIFA, an organization is not bound to preserve the original "historic dollar value" of the fund in all circumstances (this was the rule before UPMIFA), and may instead continue to spend from an underwater fund if the organization determines it is prudent to do so. The ASU would require nonprofit organizations to disclose the aggregate amount by which funds are underwater, as well as the original gift amounts, and any governing board policies or decisions to spend or not spend from such funds.

If you feel strongly about any of these proposed changes, we urge you to read the ASU in its entirety, and send any comments and suggestions to FASB to ensure that it takes into account the practical impact of these changes on nonprofit organizations. FASB has requested **public comment** on the proposed guidance, **no later than August 20, 2015**.

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