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Private Foundations Bulletin

ASU 2016-14 Impact on Financial Statement Presentation for Private Foundations

The Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities (NFPs).* The new guidance mandates improved and enhanced presentation and disclosures to help all NFPs provide clearer information to all readers of the financial statements. While most of the provisions will have a greater impact on public charities, certain aspects will also have an effect on the financial presentation of private foundations.

While ASU 2016-14 has numerous provisions, those that will specifically affect private foundations include the:

- presentation of net assets on the statement of financial position;
- presentation of investment return on the statement of activities;
- presentation of expenses; and
- requirement for enhanced disclosures over liquidity of private foundation assets.

ASU 2016-14 is effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Early adoption of ASU 2016-14 is permitted.

Net Assets Presentation

ASU 2016-14 requires that NFPs present only two classes of net assets (with donor restrictions and without donor restrictions) on the face of the financials as opposed to the prior requirement to present three classes of net assets (unrestricted, temporarily restricted and permanently restricted). Prior to ASU 2016-14, the required distinction between permanent restrictions and temporary restrictions became unclear as applicable laws diminished the relevance of the distinction, thus rendering it less useful on the face of financial statements. By no longer requiring the aforementioned distinction, ASU 2016-14 aims to reduce the complexity in financial reporting and augment a reader's understanding of the net asset presentation.

Investment Return

The FASB is aiming to provide a standard operating measure of investment return across all NFPs by requiring investment income (related to total return investing and not programmatic investing) to be reported **net of external and direct internal investment expenses**.

A private foundation may present the amounts of net investment return from portfolios that are managed differently or derived from different sources as separate, appropriately labeled line items on the statement of activities. For example, if a private foundation has net investment return generated from operating cash, it may present that return separately from net investment return generated from its endowment. In addition, if appropriately labeled, a private foundation may present the amounts of net investment return appropriated for spending separately from net investment return in excess of amounts appropriated for spending.

Direct internal investment expenses involve the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return. These include, but are not limited to, both of the following:

- Salaries, benefits, travel, and other costs associated with the officer and staff responsible for the development and execution of investment strategy; and
- Allocable costs associated with internal investment management and supervising, selecting, and monitoring of external investment management firms.

Direct internal investment expenses do not include items that are not associated with generating investment return. For example, the costs associated with unitization and other such aspects of endowment management would not be allocated.

Presentation of Expenses

As required by ASU 2016-14, NFPs must include a statement of functional expenses or note disclosure totaling expenses by function and natural class in their financial statements. Functional expense classifications include major classes of program services and supporting activities. The new ASU also requires enhanced disclosure regarding the method(s) used to allocate indirect expenses, or those costs allocated to more than one activity.

It is important to note that external and direct internal costs associated with investments that have been netted against investment return shall not be included in the functional expense analysis.

Presentation and Disclosure of Liquidity

Under the ASU, private foundations will be required to disclose both quantitative and qualitative information about the availability and liquidity of resources (assets) as follows:

- ***Quantitative*** information that communicates the availability of the foundation's financial assets to meet cash needs for general expenditures within one year of the balance sheet date (the subsequent "current" period). The 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 Boards.
- ***Qualitative*** information that communicates how the foundation manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date.

The enhanced disclosure requirement is new territory for all NFPs, not just private foundations. The ASU has no prescribed format for the liquidity, so you can customize the information to best reflect the financial status of your foundation. Remember, the notes to the financial statements convey important information about your foundation to various users of those financial statements. Use this disclosure to best describe the message you want readers of the financial statements to know about your foundation while, at the same time, meeting the ASU's requirements.

Conclusion

The modifications mandated by the FASB in ASU 2016-14 seek to update, but not overhaul, the current reporting model. The FASB's intentions are to improve information regarding net assets, financial performance and liquidity. By doing so, the FASB feels this will better enable an organization to tell their "financial story." Although these changes will have a limited impact on the private foundation industry as a whole, it is important to remember that it will significantly influence your grantees. It is important that you not only understand the changes that affect your foundation but also how this will affect your grantees.

Contact Us

We welcome the opportunity to speak with you about any questions you may have regarding this newsletter or any other subject related to accounting, audit, tax or advisory matters relative to private foundations. Please contact us:

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