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Private Foundations Bulletin

Implementation of ASU 2016-02 and Considerations for Grantmakers

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The Financial Accounting Standards Board (FASB) initially issued Accounting Standards Update (ASU) No. 2016-02 on Leases (Topic 842) over six years ago in an effort to increase transparency and bring consistency in the treatment of operating and finance leases. After several postponements, the ASU becomes effective for all not-for-profit entities (including private foundations) beginning in 2022.

Key Provisions

A quick refresher on the main provisions of ASU 2016-02 include:

- Foundations are required to recognize a "right of use" asset and a lease liability in the statement of financial position – now applicable to both capital and operating leases.
- Related party leases are required to be analyzed to understand the implications of such lease arrangements with respect to application of the ASU.
- Extension options must be included if significant economic incentive to exercise options exists.
- If the discount rate cannot be readily determined from the lease, the lessee is required to use the incremental borrowing rate.
- Entities may elect not to apply the recognition requirements of Topic 842 to short term leases (12 months or less).

Due Diligence

While ASU 2016-02 is effective for all organizations now (i.e., both for-profit and not-for-profit entities), this Standard might be particularly relevant to private foundations and other grantmaking organizations as part of their due diligence process. Fundamental questions asked during a grantmaker's due diligence process on a prospective grantee are: Who are we funding? Can they deliver programmatic results effectively?

As private foundations conduct their due diligence and measure the prospect's financial risk, they may find the long-term lease obligations now reflected on the prospect's statement of financial position is a far greater concentration of the total liabilities than initially thought. Accordingly, ASU 2016-02 will have an impact on certain key financial ratios – debt to equity, return on assets, etc. This could trigger new questioning surrounding the grantee's ability to deliver its programs effectively. Foundations should be cognizant of the impact this ASU may have on its grantees and consider adjusting their financial risk parameters accordingly.

Clarity and Transparency

It's important to remember that these new considerations in grantmaker due diligence should not be considered a hindrance to the grantmaking process and should be considered in the spirit in which the ASU was intended – to bring clarity and transparency to the organization's financial commitments.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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