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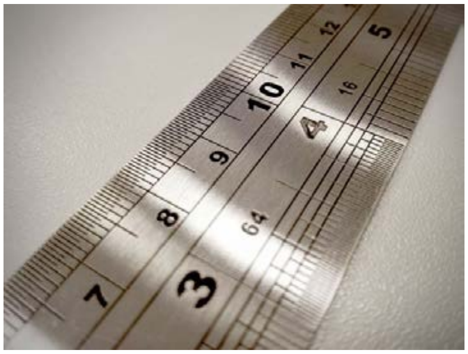
Is Your Nonprofit Ready for FASB? Making the Most of the Storytelling Potential of Financials

By **CURTIS KLOTZ** | March 27, 2018



Many nonprofits are just now becoming aware—or just now remembering—that the Financial Accounting Standards Bureau (FASB) issued new standards for nonprofit financial statements back in 2016 that apply to audited financial statements for fiscal years beginning after December 15, 2017. While the new FASB standards officially apply only to the presentation of nonprofit audits, knowing FASB well enough to be innovative in financial reporting is worth a bit of study by all nonprofits. Well-presented financials reflect an organization's mission in another language, the language of finance. Nonprofit staff and boards will do themselves right to learn the new FASB standards well enough to implement them in creative ways that tell their mission story effectively. Here are three key changes to be aware of:

1. A New Standard Regarding Donor Restrictions

The fact that donors can legally restrict their contributions to certain uses or certain times is one of the factors that make nonprofit accounting unique and complicated. One of the changes FASB made requires new terminology to describe whether contributions from donors have restrictions or not. The new standards move us from three categories to two. The categories refer to revenue or funds "without donor restrictions" and "with donor restrictions." "Without donor restrictions" includes what used to be known as *unrestricted* (funds without use or time restrictions). "With donor restrictions" includes what used to be termed *temporarily restricted* (funds restricted to a particular use or time) and *permanently restricted* (funds that carry a restriction permanently, like some endowments or scholarship funds).
The most useful way to tell our story with these categories is to have separate columns for each on the Statement of Activities (Income Statement) and the Statement of Financial Position (Balance Sheet). Using columns allows all readers of the statements to see clearly what revenue, cash, investments, and other line items carry restrictions or not. A nonprofit needs to know what is restricted or not in order to know what resources it has for general operations and which of its resources (cash, investments, and receivables) are restricted for use only on specific programs or only at specific times

2. A New Standard Regarding Liquidity

Knowing more about the availability of our resources ties to the second new FASB standard we'll mention here: liquidity. The concept of liquidity is very important for nonprofits, especially the distinction between cash versus accrual accounting—a topic for another blog!
The new FASB standards ask nonprofits to list both the quantitative measures of their liquidity (percentages and dollar amounts of resources available for use within the next year) and the qualitative measures (descriptions of how the nonprofit manages and monitors its liquidity). The list of available resources includes obvious items, like cash (that is, cash without donor restrictions) and certificates of deposit that will be paying out within the next year. Other available resources might include grant

receivables, client fee payments, a line of credit at a local bank, or any funds that are likely to be used or "released" in the next twelve months.

Even though FASB requires that the liquidity disclosure show what is available within the next 12 months, it might make more sense for an organization to focus on just the next 90 days. It all depends on the nonprofit's normal cycle of payments and receipts. For example, if an organization receives a large portion of its revenue from a government agency that takes an average of 90 days to process reimbursement requests, then establishing liquidity measures based on a 90-day cycle would make sense.
Deciding on a liquidity measure that fits its own business model is an important way for a nonprofit to tell its financial story. Sharing liquidity measures in the financial statements will give readers confidence in how well an organization can meet its immediate financial needs. Looking at liquidity is also a very important strategy for organizational leadership; we are always better off knowing the truth about our financial condition well ahead of any potential problems so we can course correct if necessary.

3. A New Standard on Functional Expenses

Organizations that are audited have long been required to break out organizational expenses into three functional categories: program services, management and general (administration), and fundraising. Now, nonprofits have to show greater detail for each category by breaking out the expenses into line items like salaries, rent, and travel. Many nonprofits already do this every year when they file the full IRS Form 990.

Unfortunately, the functional expense statement is one of the most misunderstood and misused pieces of financial information that nonprofits are required to disclose. While seeking to know if a nonprofit is effective in carrying out its mission is a perfectly valid and worthy question, the ratio of administrative and fundraising expenses to total expenses does not actually correlate to an organization's mission or financial success. That's why this practice of relying on the functional expense ratio is now called "the overhead myth."

If nonprofits are required to report a measure that neither accurately predicts nor reflects the mission or financial success of their organizations, we should at least find a way to make it useful. To that end, Propel Nonprofits has created a new graphic representation of True Program Costs in the blog, "A Graphic Re-Visioning of Nonprofit Overhead." This new visual representation puts the administrative and fundraising costs at the center of the nonprofit structure. These expenses that used to be vilified as diminishing our program effectiveness are now known as Core Mission Support. Having good organizational infrastructure in the form of solid financial accounting, strong board governance, innovative fundraising staff, and state of the art technology is seen as a boost to mission effectiveness and impact—not a drag on a nonprofit's success. Without upsetting the auditors, a nonprofit can add information on Core Mission Support and True Program Costs as supplemental information to its audit.

Using the New Standards

More important than whether the new FASB standards are in themselves positive or not is that nonprofits shape and present their financial statements in a way that best tells their story. Many nonprofits don't realize that their audited financial statements are supposed to be produced by the nonprofit staff, not the auditors. In practice, too often nonprofits are deferring to their auditors about how to display the numbers and how to write the notes. Within the bounds of FASB standards, nonprofits can learn how to use their financial statements, and the note disclosures that are part of them, to tell their own particular mission story to good end.

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