A Deeper Dive into ASU 2016-14 Implementation Issues

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The Fall Nonprofit Standard Newsletter outlined the financial reporting areas for nonprofits that will be impacted by the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* As organizations look to implement ASU 2014-16 and meet its requirements, they must account for how these changes may impact how they collect information. This article will highlight three of these areas.

Investment Expenses

As we have noted, the ASU now requires the netting of investment expenses against investment return; in addition, only the net amount of the investment return is required to be presented in the statement of activities. The investment expenses that should be netted against the investment return are both internal and external. To comply with this presentation, organizations need to fully understand the definitions of these terms and then consider how to appropriately and accurately capture this information.

The ASU states that investment returns related to total return investing and not programmatic investing should be reported net of external and direct internal investment expenses. Programmatic investing is defined as "the activity of making loans or other investments that are directed at carrying out a not-for-profit entity's purpose for existence rather than investing in the general production of income or appreciation of an asset." An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.

Organizations should review the ASU now and take these items and others into consideration when developing their implementation plan.

External investment expenses are those that are reported to the organization by the external money managers and other external investment management firms related to the management of the investment portfolio. This information will be obtained from the external investment firms based on what they have charged.

Direct internal investment expenses are defined in the ASU as those that involve the direct conduct or supervision of the strategic and tactical activities involved in generating investment return. These include, but are not limited to, 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 accounting staff costs associated with reconciling accounts, recording transactions, maintaining the unitization of pooled investment accounts and other such clerical staff time are not direct internal investment expenses, so they would not be included.

Accounting for investment expenses and the related allocation of costs is a process that organizations will have to develop to properly present these investment costs under the provisions of the ASU. The complexity of this will depend on the type of organization and the amount and nature of their investments. For example, the management of a large foundation that handles the strategic aspects of investing their assets internally will have to analyze and establish an allocation methodology for the salaries, benefits and travel related to the total return investing. Entities will need to identify all personnel who participate in the investment process and determine if they have a strategic role or not. In addition, entities may need to develop a process and make modifications to timesheets or other tracking methodologies to capture the time spent aiding the identification and allocation of these costs.

Liquidity and Availability Disclosures

Under the ASU, specific quantitative and qualitative information related to the new liquidity and availability requirements is required to be disclosed. Organizations should assess how they manage their liquid resources to ensure they can meet their cash needs for general expenditures as of and within one year, respectively, of the statement of financial position date. In addition, organizations will need to evaluate their financial assets to determine their availability to meet cash needs; consider the nature of the assets; examine the external limits imposed by donors, laws, and contracts; and account for any internal limits imposed by governing board decisions. These limitations need to be analyzed and tracked so the organization can identify its available financial assets and provide the necessary disclosures. Other qualitative issues including special borrowing arrangements or instances whereby the entity has not maintained appropriate amounts of cash as required by donor-imposed restrictions and limitations that result from contractual agreements with suppliers, creditors, loan covenants and other sources need to be identified and evaluated to prepare the appropriate disclosures.

Internal Net Asset Designations

Under ASU 2016-14, the accounting treatment for internally designated net assets hasn't changed; however, the presentation of these amounts and the disclosures have. These changes require entities to properly track these amounts and their related purpose so they can meet the ASU's disclosure requirements.

As we have noted in the past, organizations should review the ASU now and take these items and others into consideration when developing their implementation plan. Though the ASU does not have to be implemented until calendar year 2018 or fiscal year 2019 year ends, preparing for it takes careful planning, so organizations would be well advised to begin the process as soon as possible.

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