

Accounting Standards Update

Rethinking Nonprofit Financial Reporting

The Financial Accounting Standards Board (FASB) has issued new accounting standards for nonprofit financial reporting. The update, *Presentation of Financial Statements of Not-for-Profit Entities*, is designed to help nonprofits present their financials in a way that tells their story more transparently.

According to FASB, the new accounting standards are designed to address several vexing issues in nonprofit financial reporting, including:

- Complexities in the use of the required three classes of net assets,
- Deficiencies in the transparency and utility of information in assessing an organization's liquidity,
- Inconsistencies in the type of information provided about expenses, and
- Misunderstandings about and the limited usefulness of the statement of cash flows — particularly with regard to the reporting of operating cash flows.

A Clearer Picture, Inside and Out

Both internal and external audiences are expected to benefit from this new reporting structure, which provides clear details of an organization's liquidity, financial performance and cash flows.

Externally, donors and funders will be able to better assess the financial health of the nonprofits they are interested in supporting.

Internally, those charged with nonprofit management and governance will enjoy improved clarity of their organization's financial information.

In particular, the changes cover these key areas of nonprofit financial reporting:

- **Asset restrictions** — Nonprofits have traditionally been required to break assets down into three categories: restricted, temporarily restricted and permanently restricted. Under the new accounting standards, assets will be categorized either as "with donor restrictions" or "without donor restrictions." This streamlined approach will allow endowments that used to be classified as permanently restricted to be grouped with other restrictions that may be more time-limited.

- **Expenses** — Expenses will be reported by both their nature and function. Currently, only voluntary health and welfare organizations are required to allocate expenses this way. Nonprofits will have the flexibility to present expenses either on their Statement of Activities, as a sep-



arate statement or within notes to the financial statements.

- **Cash flows** — Financial statements will undergo two fundamental changes designed to make the statement of cash flows more understandable and useful:

1. Nonprofits are allowed to continue to use either the direct or indirect method for presenting operating cash flows — but are no longer required to present or disclose the indirect method (reconciliation) if using the direct method.
2. Cash flows must be classified in ways that are more consistent with classifications in the Statement of Activities.

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How to Keep Special Events Calamity-Free

Danger can lurk anywhere, but the potential for mishap is especially high any time you hold a special event. Even something as harmless as the ALS Ice Bucket Challenge had its share of danger. Sure, it was fun, but there were also instances of participants being hit in the head with buckets or slipping on the ice and falling.

Cover Yourself

Walk-a-thons, wine tastings and golf tournaments are not usually covered under your nonprofit's basic liability insurance. In most cases, you will need to get a specific, special-event policy that provides coverage for property damage (e.g., someone damages an antique chair on your nonprofit's annual tour of homes) as well as bodily injury (e.g., rambunctious siblings knocking heads in your festival's jump house).

Your best bet is to work with an insurance agent who has specific experience covering nonprofit events.

What an Underwriter Wants to Know

You'll be ahead of the game — and possibly save some money on your premiums — if you've already thought through some of the key issues that keep insurance underwriters up at night. These typically include the following:

Liquor liability — The easiest way to deal with this huge risk exposure is to restrict events where alcohol will be served to restaurants, hotels and other venues that have experienced staff on hand. If you decide to serve alcohol yourself, invest in some online training for your volunteers (your municipality may require it) and develop "sober-ride-home" protocols for guests who may have had too much to drink.

Risk transfer — Underwriters will want to know that you have transferred as much risk as possible to third parties — typically through your contracts with caterers, suppli-

ers, subcontractors, vendors and venues. Make sure that your agreements include hold harmless language and waivers of subrogation.

Depending on the situation, you'll want to obtain a certificate of insurance that names your nonprofit as an "additional insured." Before you sign any contract, have your insurance broker review the insurance section, and ask your lawyer to make sure it's written in your best interests.

Waiver of liability — For events such as a fun run or fishing derby, have each participant sign a waiver acknowledging risks and agreeing to hold your nonprofit harmless in the event of an injury. Require a parent/guardian signature for any minor participants. If you'll be holding a run or walk-a-thon, consider bringing on a risk manager to evaluate the course for safety.

Control — Insurers ultimately want to know that you will be in control during every stage of your event — from volunteer sign-in to the last guest leaving. This means having a plan in place for controlling the crowd, responding to injuries and evacuating the area in case of an emergency. Having a dedicated risk management team and safety coordinator involved is a good indication that you've taken this duty seriously.

Don't Get Out of Your League

Finally, don't get in over your head. Seriously consider whether the event is a good match for your mission and those who will be attending.

Likewise, be honest about whether your organization has the resources and skills to create and safely manage the special event. You don't want the community's first response to a mishap at your event to be, "What were they thinking?" ■

What's the Risk

Any event carries risk. But as you can see, some are riskier than others.

Low-risk events:

- Galas and auctions
- Dance-a-thons, walk-a-thons
- Non-sports competitions such as art and baking contests
- Lectures and educational events

Moderate-risk events:

- Concerts and sporting events
- Home and garden tours
- Night-at-the-museum events

High risk events:

- Any event that involves alcohol, water or mechanical equipment (jump houses, carnival rides, etc.)



A New Face for Your Financials

Start Preparing Now

The new accounting guidance on nonprofit financial reporting applies to fiscal years beginning after Dec. 15, 2017 (or calendar 2018 for calendar-year organizations). However, early adoption is permitted.

Now would be a good time to think through the impact the new accounting standards will have on your financial statements. Practically speaking, your executive director, CFO and board members will all need to understand how these changes translate into the numbers they will be seeing.

With this in mind, consider these three steps for getting everyone up to speed:

1. Review — Download a copy of the new accounting standard at <http://www.fasb.org>. Included are illustrative examples and sample financial statements your financial and accounting team can use to more clearly understand the potential impact on your organization. You might also consider sitting down with your CPA for a high-level overview, or to at least get the answers to your most pressing questions.

2. Brief and train — As the implementation date draws nearer, share with the users of your financial statements what they can expect. A brief e-mail from your executive director with a link to a briefing document



can help set the stage. Then, schedule time at a regular board meeting for your CFO to provide an update and take questions.

Note that certain financial statement users may require more formal training on the new reporting structure. Consider asking your CPA to arrange for a webinar or PowerPoint

presentation. Your audit committee — and possibly the full board — should also be briefed by your outside auditors on how the changes will impact the audit process.

3. Conduct a run-through — Prepare pro forma financial statements following the new rules to see how they will affect your organization's financial reporting. You can create a mockup of your most recently issued GAAP financial statements using the new requirements and then present it to management and the board for their feedback.

If it would be beneficial, you might even consider early adoption. Here, it's important to note that additional new FASB standards — for revenue recognition and leasing — will also be taking effect in the next few years, creating what some have called a “trifecta of standards.” You will be allowed to early adopt two of the three new standards. ■

Our experienced professionals are an excellent resource for navigating these accounting updates. Call us to learn more.

New Financial Reporting Accounting Standards

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• **Liquidity** — Financial statements will be required to provide quantitative and qualitative information that assesses a nonprofit's liquidity and how it is being managed. For example, a reconciliation in the footnotes of your balance sheet must detail what resources are available for use in the following year, and management must disclose its strategies to have cash available.

• **Endowment funds** — The amount of any endowment funds that are underwater will be reported under the new “with donor restrictions” category of net assets. Additional disclosures about the original gift amount, current fair value and

organizational spending policies must be provided.

• **Investment expenses** — The accounting change also requires the netting of external and direct internal investment expenses against investment return. Nonprofits would not be required to disclose internal salaries and benefits that are netted against investment return.

Clear Your Mind

These changes to the reporting model represent a conceptually different approach to how information is presented in nonprofit financial statements. In fact, FASB acknowledges that the new standards are “reasonably different” from current

generally accepted accounting principles (GAAP) — and that initial compliance with the rules could be challenging.

Yet, the end result for users of your nonprofit's financial statements is expected to be positive. In essence, the new standards will help donors, existing and potential board members, lenders and regulators understand the financial health of your organization — or in other words, where your money is coming from and where it's going. ■

Please contact our office for help in understanding how these reporting changes will impact your organization.

HOW CAN YOU BUILD YOUR ORGANIZATION FOR TOMORROW?



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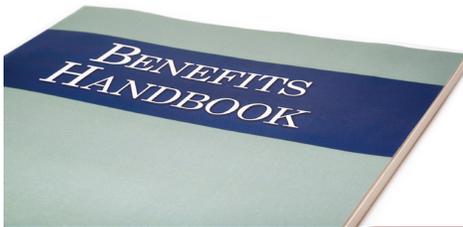
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How Dusty Are Your Docs?

Operating with outdated, inconsistent governing documents is a recipe for disaster. Over time, your organization may have changed its mission and purpose without updating its governing documents. Of particular concern are these guiding documents:

- **Articles of Incorporation** — These are charter documents that spell out your nonprofit's accountability to the public.
- **Bylaws** — These are internal rules and procedures that are not covered in the Articles of Incorporation.



- **Code of Conduct/Employee Handbook** — These are written personnel policies that outline the expectations you have of employees and perhaps a code of ethics that describes your organization's commitment to transparency and accountability.

When it comes to bylaws, problems can occur when an organization uses a boilerplate template or copies another institution's bylaws without regard to the distinctions between the organizations.

The best bylaws provide flexibility. For example, they don't confine your annual meeting to "the third Tuesday of July." Better: "The organization must have an annual meeting within 120 days after the end of its fiscal year."

It pays to conduct regular reviews of your governing documents and ask these two key questions:

1. **"Are our activities consistent with the organizational documents?"** In other words, are you doing things the way they are outlined in your original governing documents? If not, do you need to change your practices to better conform to those documents?
2. **"Are our organizational documents consistent with our activities?"** Here, the question becomes: Do you need to change outdated documents to better reflect the realities of what you are doing today?
If your activities and governing documents don't line up, it might be time to make some changes. ■



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