**Issue Paper 1**

**Session 1: November 16-17, 2017**

**Issue:** 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 and The Department’s Financial Responsibility Standards.

**Statutory Cite:** §487(c) and 498(c) of the Higher Education Act of 1965, as amended

**Regulatory Cite**: Subpart L of the General Provisions regulations, specifically 34 CFR 668.172 and the audit submission requirements under 34 CFR 668.23

**Summary of issue:**

The Higher Education Act requires all schools participating in the title IV Federal student financial aid programs to submit annual financial statements to the Department. This applies to all schools, including non-profit schools that are not otherwise exempt from this requirement under the OMB Uniform Guidance at 2 CFR Part 200 Subpart F – Audit Requirements. Under Subpart L of the Department’s General Provisions regulations, the Department determines annually whether an institution is financially responsible, in part, by calculating a composite score based on information contained in its audited financial statements. ASU 2016-14 changes some of the information non-profit schools must either report in their financial statements or disclose in their notes to their financial statements.

Changes to the information that non-profit schools report to the Department based on ASU 2016-14 could result in operational and/or administrative changes in how the Department evaluates non-profit schools’ financial statements and how those schools report to, or input data into, the Department’s systems. ASU 2016-14 moves from three classes of net assets to two classes of net assets, completely eliminating temporarily restricted net assets. What are currently considered temporarily restricted net assets must be included in one of two new classes of net assets, *net assets with donor restrictions* and *net assets without donor restrictions*. While the two classes of net assets correspond to unrestricted net assets and permanently restricted net assets, at the least, the terms used in the regulations for calculating the composite score for non-profit schools will need to be modified.

Major changes for ASU 2016-14:

1. Change from Three Classes of Net Assets to Two Classes of Net Assets

A non-profit school must present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. That is, the school will report amounts for net assets with donor restrictions and net assets without donor restrictions, as well as the currently required amount for total net assets. Temporarily restricted net assets will be eliminated. A non-profit school must also present on the face of the statement of activities the amount of the change in each of the two classes of net assets rather than that of the currently required three classes, as well as report the currently required amount of the change in total net assets for the period. These changes were made as a result of complexities about the use of the currently required three classes of net assets that focus on the absence or presence of donor-imposed restrictions and whether those restrictions are temporary or permanent.

2. Significant Additional Disclosures Concerning Liquidity

The update provides for significant additional disclosures by the non-profit school concerning liquidity. The additional disclosures are:

* 1. Amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period.
	2. Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.
	3. Qualitative information that communicates how a non-profit school manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date.
	4. Quantitative information, either on the face of the balance sheet or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of a non-profit school’s financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date. Availability of a financial asset may be affected by (1) its nature, (2) external limits imposed by donors, grantors, laws, and contracts with others, and (3) internal limits imposed by governing board decisions.
	5. Amounts of expenses by both their natural classification and their functional classification. That analysis of expenses is to be provided in one location, which could be on the face of the statement of activities, as a separate statement, or in notes to financial statements.
	6. Method(s) used to allocate costs among program and support functions.
	7. Underwater endowment funds, which include required disclosures of (1) the school’s policy, and any actions taken during the period, concerning appropriation from underwater endowment funds, (2) the aggregate fair value of such funds, (3) the aggregate of the original gift amounts (or level required by donor or law) to be maintained, and (4) the aggregate amount by which funds are underwater (deficiencies), which are to be classified as part of net assets with donor restrictions.

3.Investment Return Net of External and Direct Internal Investment Expenses

A non-profit school must present investment returns net of external and internal expenses in the statement of activities. The school is no longer required to disclose the amount of the netted investment expenses or the investment return components (income earned and net realized and unrealized gains or losses).

4.Placed-In-Service Approach

An non-profit school must use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset and reclassify any amounts from *net assets with donor restrictions* to *net assets without donor restrictions* for such long-lived assets that have been placed in service as of the beginning of the period of adoption (thus eliminating the current option to release the donor-imposed restriction over the estimated useful life of the acquired asset).

Questions for consideration by the subcommittee include:

* Are there implications from the change from three classes of net assets to two classes that should be discussed with regard to calculating the composite score?
* How could the Department use the additional liquidity disclosures in evaluating a not-for-profit schools’ financial health?
* Are there comparable liquidity disclosures for proprietary schools and, if not, should such disclosures be required of proprietary schools?
* Do the additional disclosures address when a school borrows from donor restricted funds without proper authorization? If not, should there be a required additional disclosure in the regulations?
* Does investment return net of external and direct internal investment expenses impact the composite score or the manner in which the Department evaluates a school’s financial responsibility?
* Requiring the placed-in-service approach would not have an impact on net assets, but in the year the asset is placed in service could have a significant positive impact on net assets without donor restriction. How or should the Department consider this impact in evaluating a non-profit school’s financial responsibility?