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Accounting Board Committee to Suggest New Standards for Financial Statements

By Lisa Chiu

An advisory committee of nonprofit accounting experts this week plans to recommend changes in the standards that govern how organizations present information on their annual financial statements.

The group was appointed to study nonprofit issues for the Financial Accounting Standards Board, a private organization in Norwalk, Conn., that establishes rules for financial accounting and reporting that many nonprofit groups follow to satisfy creditors, investment managers, and auditors.

The board has not made any significant changes to its standards for nonprofit accounting in nearly two decades.

But members of its nonprofit advisory committee say they believe that the accounting-standards body should adopt numerous new approaches that would allow nonprofits to provide more accurate financial statements. In addition, the committee said it wanted to make nonprofit statements easier to compare among organizations and to eliminate the problems that occur when nonprofits are required to follow the same kinds of reporting standards as businesses.

Nonprofit leaders say the changes the panel recommended could lead to big differences in how nonprofits report on their finances.

“Depending on the aggressiveness of the board, this could be significant,” says Catherine Mickle, chief financial officer at the American Cancer Society, in Atlanta. “There have been changes over the years, but nothing substantial with regard to presentation and disclosures in 20-plus years.”

Telling a Story

The most specific change the advisory committee plans to suggest is to add a section to the financial statements that would require nonprofits to provide a narrative analysis of their financial health.

This would mirror how public companies describe their operations in annual financial statements to the Securities and Exchange Commission.

It would also allow nonprofits to explain their financial story in a more compelling format and provide better context, says Ken Euwema, vice president of member accountability at United Way Worldwide and a member of the nonprofit advisory group.

“Often it’s difficult to take a look at a set of financial statements and really see what they’re communicating about how the organization is running,” Mr. Euwema says. “It’s hard for nonprofits because success isn’t measured by whether you turn a profit, it’s measured by how you are following your mission and using your resources.”

The committee also plans to urge the accounting board to:

- Redefine some key financial terms to avoid confusion. Current standards for reporting unrestricted assets, for example, are vague and often difficult to interpret, the advisory committee says. Tightening the definitions would allow nonprofits to better report their ability to cover their expenses, the committee says.
- Improve how financial data are reported in a section called the “statement of activities,” which is similar to a company’s income statement. For example, it suggested clarifying terms such as operating expenses and nonoperating expenses to create more uniformity in the financial statements of all nonprofits.

“A lot of it is inside baseball,” Ms. Mickle says of how these terms are currently defined. “If you aren’t in that world, you don’t understand what those categories mean or what they’re supposed to be telling you.”

Clarifying Rules

Annual financial statements provide detailed data about a nonprofit’s financial health and creditworthiness. Unlike the Form 990—the informational tax return that nonprofits must file with the Internal Revenue Service—the financial statements are not required by federal law, although some states require them in order to register for charity status, as do some lenders and grant makers.

And unlike the Form 990, which was recently revised to streamline how charities report their financial operations and provide a better window into their internal operations, the accounting rules for annual financial statements have been largely untouched.

Clarifying those standards could prompt nonprofits to disclose more of their financial data, committee members say.

“If you facilitate a nonprofit’s ability to tell its story financially in a way that won’t confuse people, that helps move them towards getting folks to make that information public,” says Jeff Mechanick, the accounting board’s assistant director of nonprofit entities.

Mr. Mechanick, who previously was chief financial officer at the Planned Parenthood Federation, recommended that the accounting board create the nonprofit advisory committee in 2009 to examine how the group could better guide nonprofits.

“When I got to FASB, there was a specialized advisory group for private companies and one for investors and one for small businesses, but there were none for nonprofits,” he says. “These are the first major recommendations coming out of this nonprofit advisory group.”

‘Great Ideas’

The recommendations, however, are only a first step in what is likely to be a long process. The standards board would conduct research on recommendations it likes and then devises draft standards for the public to review. It would also collect comments and advice from the committee, as well as nonprofit leaders and watchdog groups.

For now, some nonprofit leaders say the prospect of clearer rules is a welcome move.

“These are great ideas,” says Alan Strand, interim executive director of the Nonprofit Center, in Tacoma, Wash., an organization that works with local nonprofits to improve their accounting.

He particularly likes the idea of adding narratives that can give context to the numbers in financial statements. “Financial metrics for a nonprofit is a terrible way to measure effectiveness. Even if you focus on percentage metrics, such as comparing fund raising to programming, without a narrative, it’s hard to explain.”

Proposed Changes to Nonprofit Reporting

The organization that establishes national standards for financial accounting and reporting is considering making changes to the way nonprofits report their annual financial statements. Among the ideas recommended by an advisory committee:

- Require nonprofits to include a narrative explanation of their financial health and operations.
- Create new definitions for key financial terms such as unrestricted funds.
- Adopt more uniform standards on the statement of activities.