

Nonprofit Accounting Update



Presented by
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Overview

- Recent Auditing and Attestation Standards
 - SSAE No. 15, SAS No. 115, SAS No. 116
- Recent Accounting Standards
 - SFAS 157/159, FIN 48, FAS FSP 117-1
 - SFAS 161, 164, 165, 168
- Looking Ahead
 - AICPA NFP Entities Audit & Accounting Guide Update

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Recent Auditing and Attestation Standards



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Recent Auditing and Attestation Standards

- SSAE No. 15: An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements [October 2008]
- SAS No. 115: Communicating Internal Control Related Matters Identified in an Audit [October 2008]
- SAS No. 116: Interim Financial Statements [February 2009]

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SSAE No. 15

- SSAE No. 15: *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* [October 2008]
- Effective: Integrated audits for periods ending on or after December 15, 2008
- Converges nonissuer standards with PCAOB Auditing Standards No. 5 and supersedes AT section 501 – addresses approach, definitions, scope, etc.

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SAS No. 115

- SAS No. 115: *Communicating Internal Control Related Matters Identified in an Audit* [October 2008]
- Effective: Audits of financial statements for periods ending on or after December 15, 2009
- Supersedes SAS No. 112, aligns with SSAE No. 15 and PCAOB Auditing Standards No. 5
- Not applicable to SSAE No. 15 engagements

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SAS No. 115

- Revised definitions –
A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.
A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

SAS No. 115

- Revised definitions – differences with SAS No. 112
A material weakness under SAS No. 112 was triggered when there was *more than a remote likelihood*. SAS No. 115 provides for a *reasonable possibility* (as used in FAS No. 5), also "and corrected on a timely basis" was added.
A significant deficiency under SAS No. 112 was triggered when there was *more than a remote likelihood* of a *more than inconsequential* misstatement, but SAS No. 115 provides merely that it be *less severe than a material weakness, yet important enough to merit attention by those charged with governance*.

SAS No. 115

- Revised list of material weakness **indicators**
 - Indication of fraud, whether or not material, on the part of senior management
 - Restatement of previously issued financial statements to correct material misstatement due to error or fraud
 - Identification of a material misstatement that would not have been detected by the entity's internal control
 - Ineffective oversight of the entity's financial reporting and internal control by those charged with governance

SAS No. 115

- If a deficiency, or a combination of deficiencies, is determined *not to be a material weakness*, auditors must consider whether prudent officials would reach the same conclusion.
- Eliminates the list of deficiencies that ordinarily would be considered at least significant deficiencies.
- Contains a revised illustrative written communication to management and those charged with governance regarding material weaknesses and significant deficiencies noted during the audit.

SAS No. 116

- SAS No. 116: *Interim Financial Statements* [February 2009]
- Effective: Reviews of interim financial information for interim periods *beginning* after December 15, 2009
- Applies to nonissuers and companies offering securities under SEC Rule 144A or private equity exchanges
- Applies when interim financial information is intended to provide an update to year end reporting

Recent Accounting Standards



Recent Accounting Standards

- FAS 157 – Fair Value Measurements
 - Effective now for financial instruments (both assets and liabilities) and for nonfinancial assets (e.g., direct real estate investments) carried at fair value
 - Otherwise, effective for CY 2009 (FY 2009-2010)
- FAS 159 – Fair Value Option

Recent Accounting Standards

- FIN 48 – Uncertainty in Income Taxes
 - Effective now for NFPs with public debt
 - Otherwise, effective for CY 2009 (FY 2009-2010)
- FSP FAS 117-1 Endowments & UPMIFA
 - UPMIFA specific guidance is effective for NFPs in states where UPMIFA has been enacted and is effective, and only applies to donor restricted endowment funds
 - Disclosure requirements effective now for all NFPs with endowments (including board designated endowments)

Recent Accounting Standards

- FAS 161 – Derivatives Disclosures
- FAS 164 – NFP Entities: Mergers and Acquisitions
- FAS 165 – Subsequent Events
- FAS 168 – GAAP Codification and Hierarchy
 - GAAP is GAAP
 - Codification is effective for financial statements issued for periods ending after September 15, 2009
 - Applies to all nongovernmental entities

FAS 157 – Fair Value Measurements

- A “How To” Statement: Provides definition, measurement approach, disclosures for FV
 - Does *not* expand the use of FV
- Lots of implementation questions/ follow-up projects, especially in the current investment environment
 - FASB Valuation Resource Group
 - AICPA Task Force
 - FASB/IASB Financial Crisis Advisory Group

FAS 157 – Fair Value Measurements

Definition of Fair Value –

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

(paragraph 5 of FAS 157)

FAS 157 – Fair Value Measurements

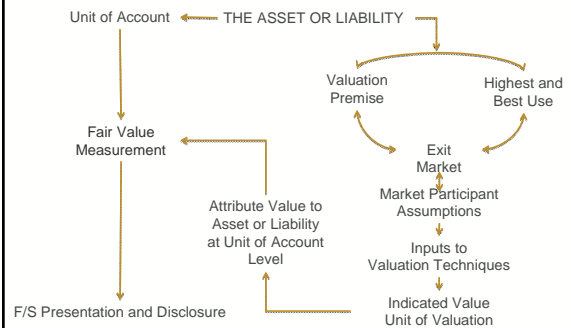
- A Quick Recap –
 - Exit price notion, from market participant perspective
 - Highest and best use for assets, credit standing for liabilities
 - Consider all available valuation approaches
 - Market, income, cost approaches

FAS 157 – Fair Value Measurements

A Quick Recap –

- Maximize use of observable inputs
 - Level 1, Level 2, Level 3 inputs
- Entity-specific restrictions do not affect fair value
 - Those that are an attribute of an asset do affect fair value.
- Disclosures
 - Especially for impact of Level 3 measurements

FAS 157: Approach to Measuring Fair Value



FAS 157 – Issues for Financial Instruments

- Assets
 - Inactive/ illiquid markets
 - FSP FAS 157-4
 - FSP FAS 115-2 and FAS 124-2
 - FSP FAS 107-1 and APB 28-1
 - Liquidity and other restrictions
 - FV vs. NAV for alternative investments
- Liabilities
 - Non-transferability
- Disclosures – sensitivity to inputs

FAS 157 – Issues for NFP Entities

- Contributions (pledges) received or made *
 - Expected PV and discount rate adj. technique [App. B]
 - Appropriate discount rate
- Split-Interest obligations *
 - Market approach
 - Appropriate discount rate
- Other non-financial assets *
 - Exit price, highest and best use
 - Effect of donor restrictions

* [May only be required to be reported at FV, when gifted]

FAS 157 – Issues for NFP Entities

- Alternative investments
 - Liquidity restrictions [Proposed FSP FAS 157-g]
- Disclosures [For those carried at FV]
 - Classification as to level
 - Investments in funds
 - Level 3 disclosures
 - Recurring vs. non-recurring

FAS 157 – Updated Provisions

- FSP FAS 157-1 (Issued 2/08)
 - Clarified that FAS 157 does not apply for purposes of lease classification or measurement under FAS 13
- FSP FAS 157-2 (Issued 2/08)
 - Delayed the effective date for FAS 157 by one year (CY 2009, FY 2009-2010) for all nonfinancial assets and liabilities, except for items recognized or disclosed at FV on a recurring basis (at least annually)

FAS 157 – Updated Provisions

- FSP FAS 157-3 (Issued 10/08)
 - Provided guidance on determining the FV of a financial asset when the market for that asset is not active
- FSP FAS 157-4 (Issued 4/09)
 - Provided additional guidance on determining FV when the volume and activity for an asset or liability may have significantly decreased and on identifying transactions that are not orderly (second stab at 157-3)

FAS 157 – Updated Provisions

- Proposed FSP FAS 157-f (Released 5/1/09)
- Measuring Liabilities Under FAS 157
 - In light of the fact that most liabilities cannot be transferred (only settled), this proposed FSP would generally not have you make adjustments for restrictions on transfer but would have you consider market prices, as a valuation input, if that liability were traded in the marketplace as an asset.

FAS 157 – Updated Provisions

- Proposed FSP FAS 157-g (Released 6/8/09) Alternative Investments (FV vs. NAV)
- Scope: Estimating FV for investments in investment companies calculating NAV per share in accordance with the AICPA Investment Companies Guide
 - Primary issue is the relationship of FV to NAV, especially liquidity restrictions that are an attribute of the investment
 - Examples: gates on otherwise redeemable hedge funds; lock-up provisions on private equity (and "evidence" of FV provided by secondary market transactions)

FAS 157 – Updated Provisions

- Proposed FSP FAS 157-g (Released 6/8/09) Alternative Investments (FV vs. NAV)
 - Would avoid the need to adjust NAV (other than roll-forward adjustments if the investment manager's report date and the balance sheet date differed) for either private equity or hedge funds but would require disclosure of significant redemption restrictions
 - Would permit a "practical expedient" in circumstances when the NAV is not representative of FV that allows the use of NAV as the FV estimate, without adjustment, if the NAV is determined in accordance with the Investment Companies Guide as of the reporting entity's measurement date

FAS 159 – Fair Value Options

- Irrevocable *instrument-by-instrument* election to carry financial instruments at fair value
 - After initial year (FY 2008-2009), only new instruments
- Reasons for issuance: Avoid intricacies of hedge accounting, international convergence, promote the use of fair value accounting for financial instruments
- Primary early adopters: Financial institutions
- NPOs: Items such as split-interest obligations, administrative ease (vs. effective interest method) vs. additional volatility and disclosures

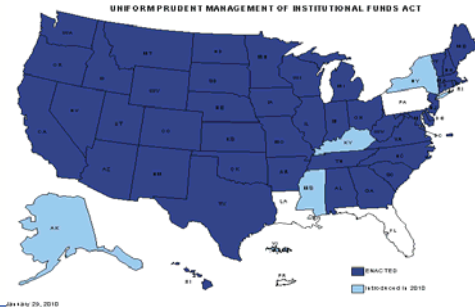
FIN 48 – Uncertainty in Income Taxes

- More-likely-than-not framework
- Areas of focus for NFPs:
 - For-profit subsidiaries
 - UBIT (including items the taxing authority could deem as unrelated business income)
 - General tax exempt status
 - Disclosures

UPMIFA – Uniform Prudent Management of Institutional Funds Act

- Georgia law: Effective July 1, 2008
- Applies to donor-restricted endowment funds – not to board-designated funds
- Eliminates historic dollar concept of UMIFA in favor of more explicit guidance on what constitutes “prudent” endowment spending
- Unless stated otherwise in the gift instrument, assets in an endowment fund are donor-restricted (time restricted) until “appropriated for expenditure”
- Applies retroactively

UPMIFA Enactment Status



FSP FAS 117-1 – Endowments & UPMIFA

- Objectives:
 - Provide guidance on net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA
 - Improve disclosures about an organization's endowment funds (both donor-restricted and board-designated), whether or not the organization is subject to UPMIFA

FSP FAS 117-1 – Net Asset Classification

- What Hasn't Changed (Much)?
 - The basic net asset classification
 - Need to consider classifying a portion of each donor restricted endowment fund as PRNA (fund of perpetual duration, generally historical dollar value)
 - PRNA generally does not increase with investment activity, other than to adhere to requirements, by donors or by law, to maintain purchasing power
 - PRNA generally does not decrease with investment activity (or, now, possible appropriations)

FSP FAS 117-1 – Net Asset Classification

- Does “plain vanilla” UPMIFA require the maintenance of purchasing power?
 - Answer: No. While the drafting committee's commentary to the Model Act certainly encourages it through prudent spending and investment policies, the final Act, unlike an earlier version, contains no such legal requirement.
 - NFPs must look for any modifications made during enactment by the particular state or any guidance put out by the state's attorney general [RI had a purchasing power provision in UMIFA not retained in UPMIFA].

FSP FAS 117-1 – Net Asset Classification

- Are permanently restricted net assets diminished by investment losses or organizational appropriations for spending?
 - Answer: No. Rationale: The organization's permanent fiduciary duty for a fund of permanent duration is unchanged, (short-term) funding/ cash management flexibility for legal purposes vs. net asset classification for financial reporting purposes.
 - Instead, temporarily restricted or unrestricted net assets would be charged – **important**: that charge is **within the endowment** not within operating funds.

FSP FAS 117-1 – Net Asset Classification

- What Has Changed?
 - Accounting significance given to the act of Board appropriation:
 - Amounts not classified as PRNA are now TRNA (time restricted) until appropriated (exception: underwater funds).
 - The “deemed spent” rule no longer applies to unappropriated amounts.

FSP FAS 117-1 – Net Asset Classification

- UPMIFA implies a time restriction until funds are **appropriated**.
- Amounts in excess of the portion classified as permanently restricted will be classified entirely as temporarily restricted not as mix of temporarily restricted and unrestricted net assets.
- The only balances in donor endowments that will be classified as unrestricted are negative balances in underwater situations.

FSP FAS 117-1 – Disclosures

- Description of governing board's interpretation of relevant law underlying net asset classification
- Description of endowment spending (distribution) policy(ies)
- Description of endowment investment policy(ies)
 - Return objectives and risk parameters
 - How the objectives relate to spending policy(ies)
 - Strategies for achieving objectives

FSP FAS 117-1 – Disclosures

- Composition of endowment by net asset class
- Endowment roll-forward by net asset class
- Also: existing disclosures on nature of restrictions (FAS 117) and underwater situations (FAS 124)

FAS 161 – Derivatives Disclosures

- Amends FAS 133 and related pronouncements
- Objectives: Improve disclosures about:
 - How and why an entity uses derivatives
 - How derivatives and related hedged items are accounted for
 - The overall impact of derivatives on an entity's financial position, results of operations, and cash flows
- Both qualitative and quantitative disclosures
- Effective for CY 2009 (FY 2009-2010)

FAS 164 – NFP Mergers & Acquisitions

- Issued: May 2009
- Effective: CY 2010 (FY 2010-2011) (mergers and acquisitions occurring in fiscal years beginning after December 15, 2009)
- Parallel project to the joint FASB/IASB Business Combinations Project that resulted in FAS 141(R) and 160 in December 2007
- Scope: Combinations between NFPs and acquisitions (purchase or gift) of a business by an NFP

FAS 164 – NFP Mergers & Acquisitions

- Tightens the guidance on which combinations of NFPs can use pooling (carryover basis of accounting)
 - Only those in which the two combining organizations each cede control
- Provides guidance on what the carryover basis entails and requires certain disclosures
 - Initial reporting period may be less than 12 months

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FAS 164 – NFP Mergers & Acquisitions

- All other combinations must use acquisition accounting (purchase accounting)
 - Identify an acquirer and fair value the assets and liabilities of the acquiree
 - Donor relationship intangibles (as opposed to donor lists) are excluded
 - Goodwill would not be recognized if the acquiree is predominately funded by contributions and investment income (as opposed to fees for services)

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FAS 164 – NFP Mergers & Acquisitions

- Acquisition accounting (cont'd)
 - Others would recognize goodwill and subsequently test it for impairment under FAS 142
 - Fairly extensive disclosures are required in the year of acquisition and possibly beyond

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FAS 165 – Subsequent Events

- Issued: May 2009
- Effective: Now – Fiscal years ending after June 15, 2009, applied prospectively
- No significant change in the subsequent events that an entity reports, either through recognition or disclosure, in its financial statements
- Introduces a concept of financial statements being *available to be issued* or *issued* when they have been widely distributed to users

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FAS 165 – Subsequent Events

- Required disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements *were issued* or *were available to be issued*
- Purpose is to alert all users that an entity has not evaluated subsequent events after that date in the set of financial statements being presented
- Applies to reissued financial statements

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FAS 168 – GAAP Codification & Hierarchy

- Issued: June 2009
- Effective: Financial statements for periods *ending* after September 15, 2009
- Purpose: to put all authoritative GAAP in one central, easily retrievable place
 - Integrate and topically organize all relevant accounting guidance issued by US standard setters (FASB, AICPA, EITF, SEC)
 - Flatten the GAAP hierarchy into authoritative vs. non-authoritative (in lieu of levels a, b, c, and d)

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Looking Ahead



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AICPA NFP Entities A & A Guide Update

- Originally Issued: 1996
- Has not been revised or amended, except for conforming changes, since that date
- Various issues have arisen since that date
- Changes have occurred in the standards setting landscape

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AICPA NFP Entities A & A Guide Update

- AcSEC no longer sets authoritative GAAP.
- AcSEC conclusions that require changes to authoritative GAAP can be implemented only by FASB.
- AcSEC can, however, publish its conclusions about best practices (from among acceptable authoritative GAAP) and implementation guidance about authoritative GAAP.

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AICPA NFP Entities A & A Guide Update

- 2009 version conformed for FASB codification
 - Style
 - Geography
- Certain issues may be addressed by AcSEC
- Certain issues must be addressed by FASB

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AICPA NFP Entities A & A Guide Update

Some of the **tentative conclusions** reached by AcSEC to date in discussing the NFP Entities Guide.

Keep current on the project at

http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/expertpanel_notforprofit.htm

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NFP Guide Update – Tentative Conclusions

Contributed Use of Facilities – Journal Entries

- NPO gives free rent or a promise to give free rent
- Reported as a contribution made
- Donor should credit rent income

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NFP Guide Update – Tentative Conclusions

Remainder Interest in Real Estate

- Split interest agreement, e.g. “Life Estate”
- NFP receives an irrevocable contribution of real estate (personal residence or farm)
- Title passes to the NFP
- Donor retains irrevocable life use interest

NFP Guide Update – Tentative Conclusions

Remainder Interest in Real Estate

- NFP reports real estate (at FV on date of transfer) without any consideration of usage limitation
 - Buildings depreciated to be consistent with FAS 13 for rental property
- NFP reports a liability for the life use interest, measured at FV, reported as deferred revenue
 - FV calculated based on actuarial life expectancy of donor (retained life use)

NFP Guide Update – Tentative Conclusions

Remainder Interest in Real Estate

- Amortization of deferred revenue liability:
 - “Day 2” accounting reflects amortization of liability as time passes, based on actuarial life expectancy of donor
 - Reduction of liability offset by increase to changes in value of split-interest agreements
- Cash flows for maintaining the RE (e.g. property taxes, utilities, and repairs and maint.) reported as period costs, therefore result in no reported liability

NFP Guide Update – Tentative Conclusions

Related Party Disclosures

- All transactions with related parties should be disclosed including **contributions** to/from related parties
- Related parties include:
 - Supporting organizations (sometimes referred to as *509(a)(3) organizations*, based on their discussion within IRC) that are not consolidated or combined in the FS
 - Brother/sister entities not consolidated or combined

NFP Guide Update – Tentative Conclusions

Related Party Disclosures

- Related parties include (cont'd):
 - Parties providing concentrations in revenues and receivables
 - Officers, board members, founders, certain substantial contributors, and their immediate family members (sometimes referred to as *disqualified persons* based on their discussion within IRC, significant influence)
 - Other entities subject to significant influence by officers, board members, founders, and substantial contributors

NFP Guide Update – Tentative Conclusions

Losses On Endowments

- Should they be reported fund-by-fund or aggregated?
- Paragraph 12 of FAS 124 discusses reporting losses on donor restricted endowment funds:
 - In the absence of donor stipulations or law to the contrary, losses on investments of a donor-restricted endowment fund shall reduce TR NA to extent that donor-imposed TR on net appreciation of fund have not been met before the loss occurs; any remaining loss shall reduce UR NA.
- GAAP requires the calculation and reporting of losses to be on a fund-by-fund basis

NFP Guide Update - Tentative Conclusions

Net Asset Classification in Consolidation

- Authoritative GAAP applied to the NA from the perspective of the reporting entity as a whole
- Look through the existence of separate entities for subsidiaries, combined entities, or financially interrelated recipients
- Classifications for the reporting entity as a whole may differ from classifications in the separate FS

NFP Guide Update – Tentative Conclusions

Recording Beneficial Interests in Charitable Trusts When the NFP is Not the Trustee

- To recognize, the NFP must be irrevocably and unchangeably a beneficiary of the trust interest (not always true even though the trust is irrevocable)
- What if the NFP has reliable and verifiable evidence that the interest exists, but is unable to obtain necessary information to measure such interests?

NFP Guide Update – Tentative Conclusions

Recording Beneficial Interests in Charitable Trusts When the NFP is Not the Trustee

- The NFP generally would need the following info in order to record its beneficial interests in trust:
 - Copy of trust doc, or other information, to verify trust's existence
 - Sufficient information to value the interest - such as the assets held by the trust, payout rates, and ages of all life beneficiaries

NFP Guide Update – Tentative Conclusions

Recording Beneficial Interests in Charitable Trusts When the NFP is Not the Trustee

- If after making and continuing to make **exhaustive efforts** to obtain that necessary information, the NFP is unable to do so...
 - NFP should disclose known facts and circumstances pertaining to interest without reporting it as an asset.

NFP Guide Update – Tentative Conclusions

Recording Beneficial Interests in Charitable Trusts When the NFP is Not the Trustee

- If sufficient info becomes available [and if the NPO did not have “known” or “knowable” information (**after exhaustive efforts**) in the prior period]
 - NPO should recognize the contribution revenue and beneficial interest asset in the year in which the information becomes available and should not report a prior period adjustment.

Questions?

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