FICPA 27th Annual Accounting Show

Non-Profit Update

Presented by:
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Agenda

- The Current Environment
- International convergence projects, FASB projects and recent pronouncements
- FASB Not-for-Profit Advisory Committee (NAC): activity, recommendations, response
- AICPA Audit and Accounting Guide *Not-for-Profit Entities* update
- Compliance!

The Current Environment

- IFRS – SEC still thinking about it
- House Ways and Means Subcommittee Hearings – 7/25/12
- The World of Reapplications
- IRS “Letter of the Law” rulings
- Increase in volume/complexity of footnotes
- Supreme Court ruling on “Healthcare”
- Change as a way of life
- COMPLIANCE!!

The World of Re-applications

- The IRS issued a new Automatic Revocation List dated August 13th, the list includes nearly 446,500 revoked entities.
- 333 entities have been removed from the list since July while 2,089 new entities have been added.
- October, 2011 = 1% (4,000 reinstatement apps/355,000 total revocations)
- June, 2012 = 4% (19,000 reinstatement apps/436,000 total revocations)

The World of Re-applications

- During fiscal year 2011, the IRS averaged about 156 determinations per day (excluding reinstatement applications). Through June of this fiscal year, reinstatement applications added an additional 56 cases per day to the IRS workload.
- From June, 2011 through August 13, 2012, the IRS approved 9,424 reinstatement applications.

Wording on Charitable Receipts

- Taxpayers claimed a charitable contribution deduction primarily made up of checks written to their church for amounts larger than $250

Wording on Charitable Receipts

- The church acknowledged its receipt of the contributions on a year-end statement to the taxpayers, but there was no language concerning whether any goods or services were provided in consideration for the contributions

Wording on Charitable Receipts

- The Tax Court disallowed the deduction and reminded taxpayers that the terms of the statute require an affirmative statement that no goods or services were received

$18.5 Million Charitable Deduction Wholly Denied

- The Tax Court has denied outright a real estate appraiser's charitable contribution deduction for millions of dollars worth of properties donated to a CRUT

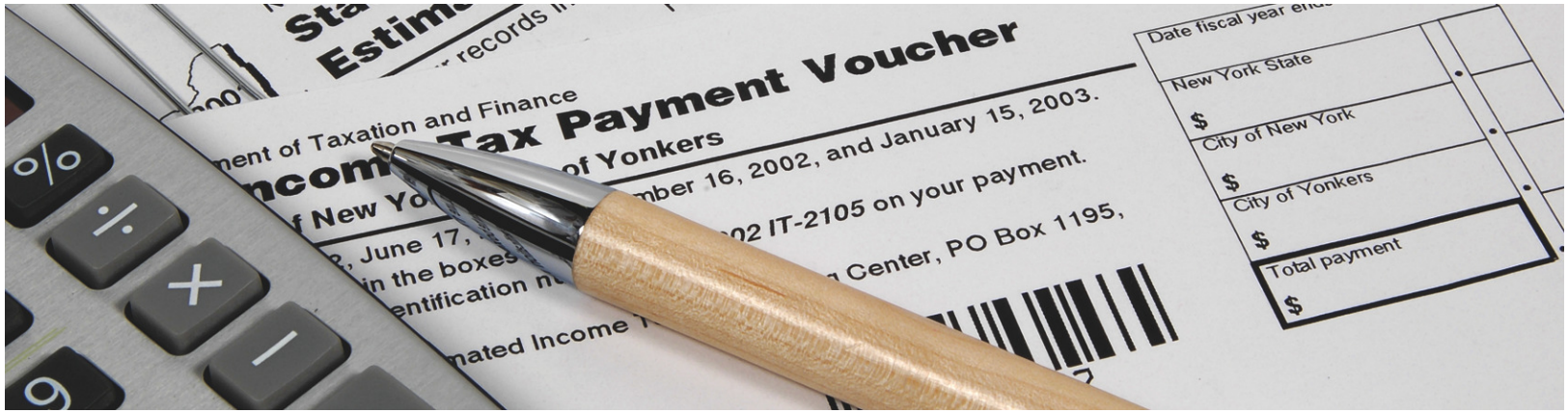
$18.5 Million Charitable Deduction Wholly Denied

- Although the Court acknowledged that the donations were made, and speculated that the donor's self-appraisals actually undervalued the real estate, the deductions were denied because he failed to satisfy the substantiation requirements

FASB Disclosure Framework Project

- **Goal: disclosure standard or conceptual framework guidance that helps reduce disclosure overload while making disclosures more comparable and effective**
- **Two approaches within project:**
  - **"Top down" (development of principles)**
  - **"Bottom up" (looking at actual current disclosure requirements)**
- **To address GAAP complexity for all entities**
- **ITC issued in July. Comment period ends November 16, 2012**

International Convergence Projects & FASB Projects



International Convergence

- Convergence with international standards continues, but is not yet complete
- International standards are not specific to NFP entities and none are on the horizon
- IFRS provide for the consideration of national standards and user acceptance
- Key projects to monitor: Leases, Revenue Recognition and Financial Instruments

Update on Key Convergence Projects

- Leases
- Revenue Recognition
- Financial Instruments

Leases Project

- Proposed right-of-use model for lessees
- Feedback: general agreement for on-balance sheet treatment but concerns about complexity:
  - Measurement (renewal options, contingent rents, short-term leases)
  - Expense pattern/categorization (front-loading, cost recovery allowability)
  - User concerns about impact on balance sheets
- Re-deliberations are still ongoing with respect to measurement simplification

Leases Project

- Pursued and discontinued finance versus other-than-finance distinction, but FASB and IASB are now “re-mulling”
- Revised ED now expected later in 2012, with likely 120-day comment period
- Final standard expected to be issued in 2013
- Effective date for public entities now likely 2016
- Likely deferral for nonpublic entities for one or two years beyond that

Leases Project - Preparing for Change

- Inventory all leases [Including donated space]
- Assess capitalization threshold and materiality
- Monitor the continued developments in the project at fasb.org
- Depending on final decisions:
  - Understand any potential impact on debt financial covenants (debt/equity ratios), metrics
  - Understand any potential impact on cost recovery agreements

Revenue Recognition Project

- Contracts with customers
- Excluded:
  - Donations
  - Collaborative arrangements
- May significantly change recognition pattern for some industries, but probably not for most NFPs
- Bad debts as contra-revenue
- Disclosure exemptions for nonpublic entities

Revenue Recognition Project

1. Identify the contract(s) with a customer
2. Identify the separate performance obligations in the contract
3. Determine the transaction price
   - Critical change: credit risk only affects measurement, not recognition
4. Allocate the transaction price to the separate performance obligations
5. Recognize revenue when the entity satisfies each performance obligation

Revenue Recognition Project

- Revised ED comment deadline was March 13, followed by public roundtables in April and May
  - Separate roundtable dedicated to private companies and NFPs on May 8 in Salt Lake City
- Expected to be issued in 4Q 2012 or 1Q 2013
- Effective date for public entities no earlier than 2015, perhaps later
- Likely deferral for nonpublic entities for one or two years beyond that

Financial Instruments Project

- Classification and Measurement:
  - **NFP contributions (pledges) receivable and contributions payable are excluded**
  - For the most part, changes are no longer significant for NFPs
  - Loans receivable and liabilities remain at cost
  - NFPs already report debt securities at FV (key change for business entities)
  - Liquidity risk disclosures being developed
- Impairment: FASB and IASB continue to work towards an improved and converged model, going beyond incurred losses

EITF Issue – Sale of Donated Securities

- EITF Issue No.12-A, Classification of the Sale of Donated Securities in Statement of Cash Flows
- Comment period for proposed ASU (based on EITF consensus) ended in mid-July; was discussed by EITF last week

EITF Issue – Sale of Donated Securities

- Provides that a NFP should classify cash receipts from the sale of donated securities that upon receipt are directed for sale and for which the NFP has the ability to avoid significant investment risks and rewards through near immediate conversion into cash as operating or financing activities in the statement of cash flows, rather than as investing activities
  - Operating unless restricted to a long-term purpose, e.g., endowment or plant, then classified as financing activities
  - Consistent with cash contributions

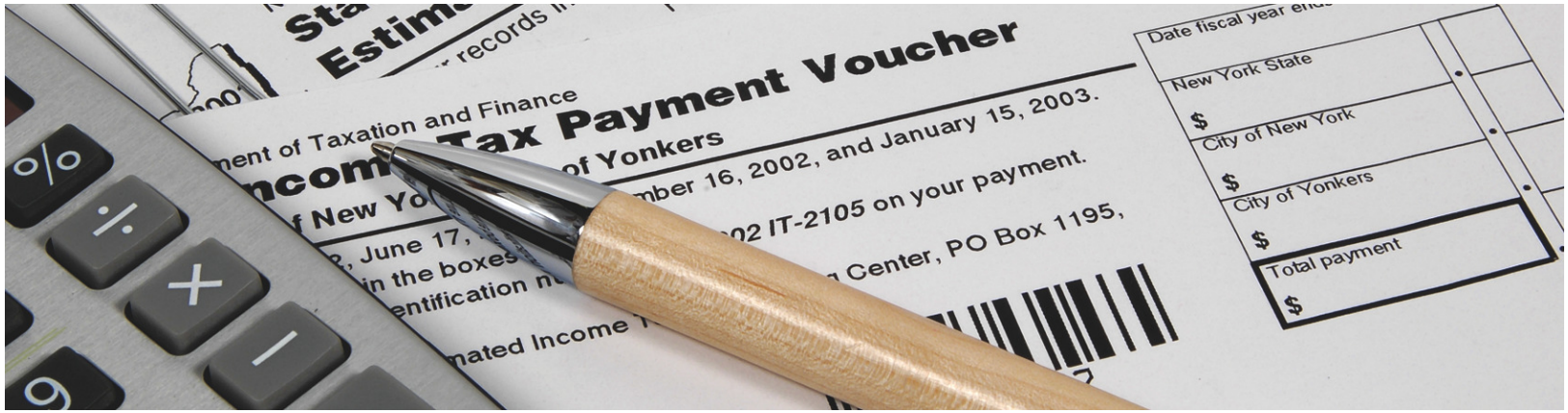
EITF Issue – Affiliate Services

- EITF Issue No. 12-B, Services Received From Employees of an Affiliated Entity
- EITF reached a consensus that the expenses related to all personnel services that are regularly performed for the recipient NFP should be recognized in the NFP's stand-alone financial statements and should be measured at the actual costs incurred by the affiliate under common control
    - Contributed services criteria would no longer be applied when reimbursement isn't sought

EITF Issue – Affiliate Services

- Affiliate – "*A party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity.*"
- Control – "*the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.*"

FASB Not-for-Profit Advisory Committee (NAC)



FASB Not-for-Profit Advisory Committee (NAC)

- Created in October 2009 as a standing FASB resource to obtain NFP sector input on:
  - Existing guidance
  - Current and proposed technical agenda projects
  - Longer-term issues affecting those organizations
- 17 members (including preparers, auditors, users, academics, regulators, analysts and legal) plus 4 participating observers
- NFP resource group (over 170 members)

Improvements to NFP Financial Reporting

- Marquis project: Three subgroups worked to identify potential improvements in NFP financial reporting, discussed at the September 2011 NAC meeting
- Objectives:
  - Enhanced clarity and consistency
  - Improved understandability for users
  - Better presentation of operations (business model and how revenues fund expenses), liquidity, resource availability and use

FASB NAC Subgroups

- Reporting financial performance
  - Statements of Activities and Cash Flows and related notes: operating measures, net asset classes, functional and natural expenses, cash flow presentation, etc.
- Reporting liquidity/financial health
  - Balance Sheet and related notes: liquidity, other financial health measures
- Telling the story
  - MD&A, functional expense reporting/ segment reporting, summary financials

FASB NAC Recommendations

- Establish FASB projects to:
  1. Reexamine net assets classes and improve how liquidity is portrayed in NFP statements
  2. Improve reporting of financial performance in statements of activities and cash flows
  3. Reexamine NFP footnotes, streamline disclosures for improved relevance and clarity
  4. Consider management discussion and analysis (MD&A) to tell the organizations financial story

FASB Response to NAC

- In November 2011, the FASB added two financial reporting projects to its agenda:
  1. **NFP financial statements** – *a standards project* to address NAC recommendations (1 – 3) concerning reexamining net assets and liquidity, reporting financial performance and statement presentation, and streamlining notes
  2. **Other NFP financial communications** – *a research project* addressing NAC recommendation (4) to better tell the organizations financial story (MD&A)

FASB NFP Financial Reporting Projects

Standard-Setting Project

- Reexamine Net Asset Classifications and Improve Liquidity Information
- Improve Reporting of Financial Performance
- Streamline and Improve NFP-Specific Disclosures

Research Project

- Other Financial Communications (explore best practices, including management commentary)

Net Asset Classes

Might the current three classes of net asset based on donor-imposed restrictions be improved?

- Are they still relevant and most useful?
- Can they be improved to better convey information about liquidity and financial performance? For example:
  - Should *donor-restricted* classes be expanded to include restrictions imposed by other sources (for example, limits imposed by statutes, debt covenants and other contracts)?
  - Should net asset classes be narrowed to just two (e.g., donor-restricted and other) with use of subclasses and/or notes?

Liquidity and Financial Health

How can we best improve information about an entity's financial health, particularly the liquidity of its resources and its financial flexibility?

- Limits on assets
- Demands on assets (e.g., maturity of liabilities and other commitments)
- ded
  :

Unrestricted	Restricted
• Spendable	• Spendable
• Designated	• Limited
• Nonspendable (e.g., PP&E)	• Nonspendable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"Telling the Story" (MD&A)

- NAC: Financial Reporting can be enhanced through other narrative communications, such as:
  - Management commentary that explains financial in information provided in financial statements, including trends over time
- Issues include:
  - Are standards needed? If not, would they be helpful?
  - Should such information be required or encouraged? If required, for all NFPs or only certain types?
  - If standards are to be developed, should a reporting framework require certain components?

FASB Response to NAC

- Has formed project resource groups and is completing detail project planning
- Podcast explaining the projects is available on the FASB website
- Board public expectation session on May 16
- Ongoing elevation of focus on NFP issues, for example on fair value measurement of gifts-in-kind and others

NFPs as Public vs. Nonpublic Entities

Current FASB project reexamining what's a Nonpublic Entity for standard setting

Impacts on accounting and financial reporting

- Current disclosures, effective date, transition
- Future: potentially greater impact

Phase I: business entities

- Tentative conclusions contained in Appendix to Private Company Framework ITC

Phase II, on NFPs, now underway

- Current dividing line within NFPs: conduit debt
- What should the dividing line(s) be?

NAC Discussions of Public vs. Nonpublic

NAC members have agreed that NFPs share some attributes of nonpublic entities

However, they are generally more similar to public entities

- **Generally, broader user base with less access to management**
- **Public accountability created via donations and tax exemptions**
- **Generally, governing boards are considered part of management, but nonprofit boards have a special role in ensuring public accountability and should be considered as users of financial statements**

NAC Discussions of Public vs. Nonpublic

This does not mean that NFPs should be treated like public companies

- NFPs have limited resources like private companies
- Some information that is important to public company investors is irrelevant to users of NFP financial statements

NAC Discussions of Public vs. Nonpublic

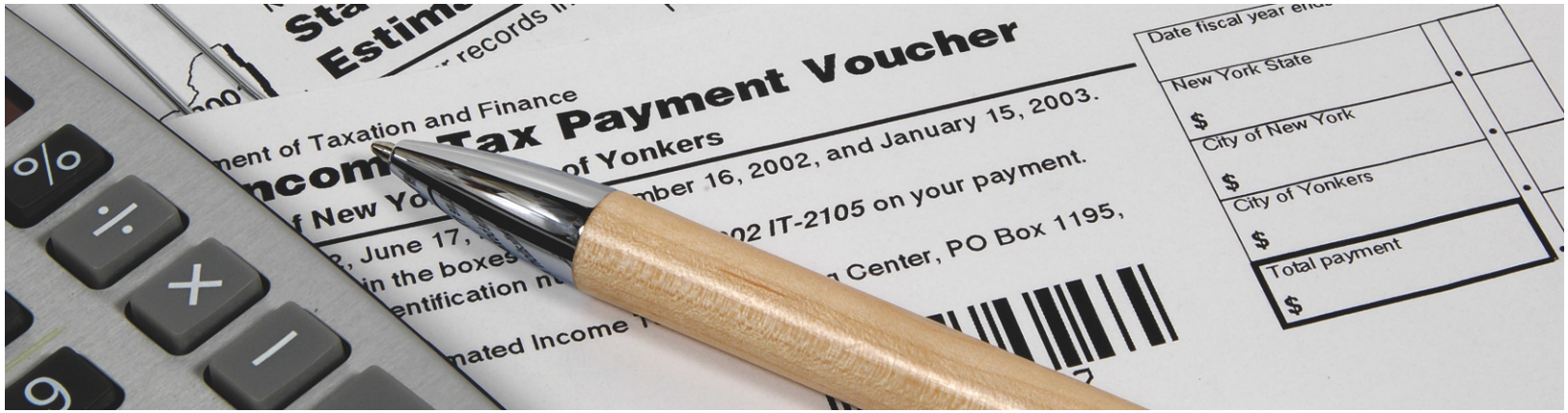
This does not mean that NFPs should be treated like public companies…

- NFP stakeholders are interested in the entity's fiscal sustainability and its ability to repay debts, not the value of the entity for the purpose of trading shares
- There may be a subset of NFPs that are more like private companies (e.g., local membership clubs)

Financial Reporting Tips (Now)

- Consider FS improvements that can be made now, without standards changes:
  - Financial reporting, Liquidity, Telling the story
- Present an annual report or MD&A to explain:
  - Outputs
  - Financial health
  - Operations
  - Liquidity
  - Risks
- Focus attention on risks and outcomes/ends

AICPA Audit and Accounting Guide
Not-for-Profit Entities update



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AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- The AICPA Financial Reporting Executive Committee (FinREC), Not-for-Profit Entities Expert Panel, and the Not-for-Profit Guide Task Force are expected to release for comment a new comprehensive revision of the Audit and Accounting Guide *Not-for-Profit Entities* in the fall (2012), expected final issuance in 2013

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- This is the first comprehensive revision, other than annual conforming changes, since the Guide was first released in 1996
- Considered over 100 issues, presented many issue documents to AcSEC | FinREC
- Now clearing chapters and additional issues
- Authoritative and non-authoritative information

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Reporting the Contribution Portion of Charitable Gift Annuities	Whether an NFP should report the contribution portion of a charitable gift annuity as unrestricted regardless of state requirements regarding required levels of annuity reserves and allowable types of related investments.	To be considered as part of the Not-for-Profit Financial Reporting: Financial Statements project, which is expected to review the current net asset classification scheme.

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Reporting Investment Expenses	How investment expenses should be presented and disclosed by a not-for-profit entity. (Whether they should be presented gross on the face of the statement of activities or disclosed if netted against investment return and whether they should be included and functionalized in the statement of functional expenses.)	The FASB Chair recommended that the presentation of investment expenses on the statement of functional expenses be addressed as part of the FASB's ongoing project that addresses corrections and improvements to the Codification. The disclosure of investment expenses should be considered as part of the Not-for-Profit Financial Reporting: Financial Statements project, as that project is expected to review existing NFP-specific disclosure requirements.

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Recognition of Beneficial Interests in Trusts Held by Others When Information to Measure Is Unavailable	When an NFP should recognize its beneficial interest in specified assets if it is the beneficiary of a split-interest agreement held by a third party but determines it does not have the information available to measure the fair value of that beneficial interest.	The FASB Chairman recommended that the FASB address this issue as part of the FASB's existing project that addresses corrections and improvements to the Codification.

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Subsequent Measurement of Other Investments	Whether the NFP subsector guidance for subsequent measurement of other investments in Section 958-325-35 should be amended to conform the guidance for all NFPs.	The FASB Chairman recommended that the Board consider this issue as part of its current projects on Accounting for Financial Instruments, Investment Companies, and Investment Property Entities, with a focus on conforming the impairment analysis.

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Classification of Gifts of Securities Immediately Sold in the Statement of Cash Flows	How NFPs should classify the sale of donated securities that immediately upon receipt are directed for sale and conversion to cash in the statement of cash flows.	**This issue was added to the EITF agenda was discussed at the March 15, 2012 EITF meeting. Consensus reached, ratified by FASB, just exposed for public comment as a proposed ASU.**

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Employee Services Contributed by an Affiliate	Whether recipient NFPs should apply the *contributed* services guidance in paragraph 958-605-25-17 for recognizing personnel costs incurred on its behalf by an affiliate. If not, what recognition and measurement guidance should the recipient NFP apply.	**This issue was added to the EITF agenda and was discussed at the March 15, 2012 EITF meeting. No consensus reached yet. Discussions expected to continue at future EITF meetings**

Issues Referred to the FASB in Updating the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

Issue	Description	Action Taken
Statement of Functional Expenses	Whether the statement of functional expenses should be required for more types of donor-supported not-for-profit organizations.	To be considered as part of the Not-for-Profit Financial Reporting: Financial Statements project.

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 1, Introduction
  - Conformed scope with Healthcare Guide
  - Other changes and scope issues
  - Guide is for GAAP, there is no IFRS NFP model
    - Most of the guidance in ASC topics 105 - 899 applies to NFPs
    - Specific NPF guidance can be found in ASC topic 958
    - Appendix A to Chapter 1 discusses audits, reviews and compilations and has some useful FAQs

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 2, General Auditing Guidance
  - Updated and to be conformed with Clarity project
  - Other chapters focus on NFP specific guidance

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 3, Financial Statements and General Financial Reporting Matters
  - Expanded coverage of related entities, LLPs, mergers and acquisitions, collaborative arrangements
  - Exhibit 3-2 is a four page chart that lists 22 relationships and refers you to specific guidance
  - Over 20 pages of guidance and examples

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Expanded identification of related parties including - officers, board members, founders, certain substantial contributors, and their immediate family members: other entities subject to significant influence by officers, board members, founders, and substantial contributors; supporting orgs and affiliated entities; parties concentrations in revenues and receivables
- FinREC believes NFPs need not name donors

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

Chapter 3, cont.

- Expanded liquidity issues
  - Assets whose use is restricted by donors, law or intent
  - Assets held by a subsidiary organization whose use is limited
- Disclose on the face of the balance sheet or in the notes the nature of the asset, the purpose for which the asset is segregated and the act causing the segregation

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Para 3.37 – FinREC recommends that all NFP's supported by the general public present a statement of functional expenses as a basic financial statement
  - FinREC suggests that an NFP is supported by the general public if contributions are 20 – 30% or more of total revenue and support, excluding government support

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 4, Cash, Cash Equivalents, and Investments
  - Expanded coverage – Interest in other entities due to unique NFP investment options, other assets, FV options, investment pools
  - For segregated asset, disclose – Type of asset(s) comprising the line item: purpose for which the asset is segregated: act causing asset to be segregated (i.e., specific asset is donor restricted, related net assets are donor restricted, or governing board designated)
  -

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 5, Contributions Received and Agency Transactions **(this chapter changed the most)**
  - Increased focus on core recognition principles
  - Additional guidance on FV measurements
  - New section on naming opportunities
  - New sections on reporting and valuing noncash gifts including - GIK, fundraising & informational materials, advertising, media time or space, below market loans, bargain purchases

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 6, Split Interest Agreements and Beneficial Interests in Trust
  - New coverage of life interests in real estate
  - Many technical enhancements and clarifications
  - Agreements can be irrevocable, but the NFP's interest can be revocable
  - Accounting depends on who serves as trustee
  - Continuing discussion on FV for SI obligations

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 7, Other Assets
  - Clarified reporting sale of inventory gross vs. net
    - Sales of gift certificates and merchandise contributed for fundraising events should be recognized as adjustments to the original contributions when sold
    - For incidental sales, gross or net is permitted
  - Expanded discussion of prepaid and deferred costs including production of revenue producing assets

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 8, Programmatic Investments (IRS definition)and Microfinance *NEW*
  - Including loans, equity interests, and other interests that further the exempt purpose of the NFP
  - Determination made when the transaction occurs
  - The amount recognized for a program loan is the present value of cash flows expected to be collected
  - The difference between the PV and cash advanced (or FV of transferred asset) would be recognized as a contribution made. (No allowance for doubtful accounts)

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 9, Property, Plant and Equipment
  - PP&E owned by others
    - NFP often have the right to use property without making lease payments or pay at rates significantly below market
    - A contribution is inherent in such situations
  - Capitalized interest depends on nature of debt
    - Restricted tax-exempt debt - all interest is capitalized net of interest earned on unused proceeds until asset is ready for intended use

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 10, Debt and Other Liabilities
  - Expanded sections on:
    - Municipal bond debt including IRS considerations
    - 3rd party credit enhancements (bond insurance, letters of credit, guarantees)
    - Extinguishments and debt modifications - a debt obligation is derecognized if an NFP reacquires its bonds though open market purchases
    - Three types of refunding– current, advanced (defeasance) and crossover
    - Due on demand, subjective acceleration, covenants

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 11, Net Assets and Reclassifications of Net Assets
  - Expanded guidance on fiduciary responsibility to meet donor restrictions
  - Expiration of restrictions (time and purpose)
    - Grant to award scholarships over four years
    - Grant to construct new facilities
    - Implied time restriction policy for property (useful life or when placed in service)

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Changing net asset classifications reported in a prior year
  - Individual net asset classes, rather than net assets in the aggregate (total net assets) are relevant in determining whether an NFP's correction of net asset classifications previously reported in prior years' financial statements is an error in previously issued financial statements

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 12, Revenues and Receivables from Exchange Transactions
  - Expanded guidance and disclosures
  - In some circumstances NFP's bill customers for exchange transactions prior to the time at which revenue should be recognized. For example a school bills students for tuition prior to the beginning of the school term. In such cases, FinREC believes NFPs should not recognize the receivable or revenue

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 13, Expenses, Gains and Losses
  - Expanded discussion about contributions made reporting, contributed use of facilities
  - Encourages reporting of major programs
  - If NFPs make contributions to other NFP's, FinREC believes that it is best practice to separately identify such contributions from other program expenses
  - NFPs that provide free use of facilities to other NFPs should report rental income & contributions

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 14, Reports of Independent Auditors
  - Minimal changes

AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 15, Tax & Regulatory Considerations
  - Expanded discussion about laws and regulations
  - IRS exempt organization considerations
  - State and local registration and gaming issues
  - Income tax positions
  - UPMIFA
  - Securities regulation

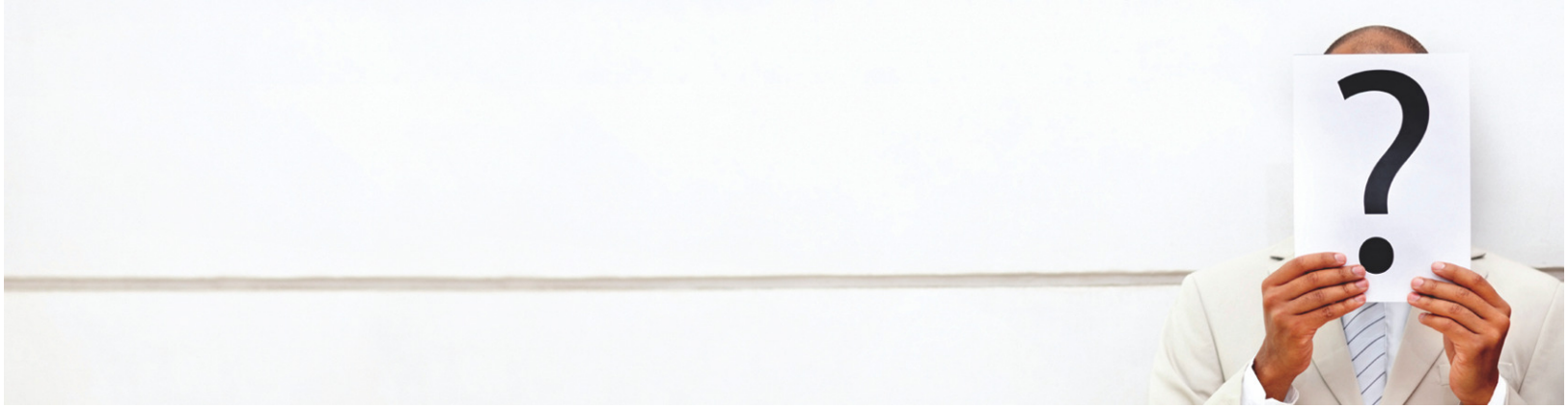
AICPA Audit and Accounting Guide *Not-for-Profit Entities* update

- Chapter 16, Fund Accounting
  - Enhancements, clarifications and examples

Staying Current

- Sign up for electronic FASB *Action Alert*
- FASB on Twitter
- Access www.fasb.org
  - Nonpublic Entities portal on website
  - Project summaries
  - FASB in Focus executive summaries
  - Podcasts
  - Webcasts: Including Semiannual FASB Updates for Nonpublic Entities (for CPE!; next one will be on June 28, 2012)

Questions and Comments?



Thank you!

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