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## FASB Update

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Schneider Downs & Co. Inc.

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## FASB Update

- **Projects of Central Importance to NPOs**
  - Leases
  - NFP Reporting: Financial Statement Presentation
  - NFP Reporting: Other Financial Communications (MD&A) (research project)
  - Disclosure Framework
- **Other Projects of Note for NPOs**
  - Revenue Recognition
  - Accounting for Financial Instruments
  - Going concern
  - Definition of a Nonpublic Entity
  - Government Assistance (pre-agenda research)



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## FASB Update

- **Some Recently Issued Standards**
  - Cash flow Presentation of Sale of Donated Financial Assets (ASU 2012-05)
  - Personal Services from Affiliates (ASU 2013-06)
  - Joint and several Liability Arrangements (ASU 2013-04)
- **Other Activities**
  - International
  - Private Company Council



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### Leases

**Project Objective**

- Increase transparency & comparability among organizations that lease assets, by recognizing assets & liabilities that arise from lease transactions on a lessee's balance sheet.

**Convergence**

- Boards have remained converged on major decisions.

**Next steps**

- Revised Exposure Draft issued in May 2013.

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### Proposed Right-of-Use Model

*A lease contract is one in which the right to control the use of an asset (for a period of time) is transferred to the lessee.*

Lessor

➔

Right of Use

➔

Lessee

Largely converged on decisions

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### The Rationale (Lessee)

**What the lessee obtains**

- Right to use asset
- Obligation to pay for that right

**Importance of leased asset**

- Not all leases are the same

**How best to reflect those contracts in lessee's income statement**

- Amortization on ROU asset
- Straight-line lease expense

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### Classification (Lessee & Lessor)

**Lessee consumes more than insignificant portion of leased asset**

- Leases of assets other than property *unless*:
  - Lease term is insignificant relative to economic life of asset or
  - PV of lease payments is insignificant relative to FV of asset

**Lessee does not consume more than insignificant portion of leased asset**

- Leases of property (land and/or a building) *unless*:
  - Lease term is major part of remaining economic life of asset or
  - PV of lease payments is substantially all of FV of asset

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### Classification of leases - examples

**More than insignificant** | **Insignificant**

- Vessel (20yrs)<sup>1</sup>
- Truck (4yrs)<sup>2</sup>
- Vessel (5yrs)<sup>1</sup>
- Comm. Property (10yrs)<sup>1</sup>
- Car (3yrs)<sup>4</sup>
- Airplane (8yrs)<sup>2</sup>
- Comm. Property (30yrs)<sup>1</sup>

Assumed economic life of:  
<sup>1</sup>40 years <sup>2</sup>25 years <sup>3</sup>10 years <sup>4</sup>6 years

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### Redeliberations – Lessee Model

Balance Sheet		Income Statement
Dr. ROU asset <sup>2</sup> Cr. Lease liability <sup>1</sup>	Lessee consumes more than insignificant portion of leased asset  Lessee does not consume more than insignificant portion of leased asset	Amortization expense Interest expense  Lease Expense

<sup>1</sup> Measured at present value of lease payments  
<sup>2</sup> Initially measured at same amount as liability, plus prepayments and initial direct costs

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### Redeliberations – Lessor Model

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    graph LR
      A[Asset subject to lease] --> B[Lessee acquires more than insignificant portion of leased asset]
      A --> C[Lessee does not acquire more than insignificant portion of leased asset]
      B --> D[Receivable & residual approach]
      C --> E[Approach similar to operating lease accounting]
    
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### Leases - Where We Are Now

2010	2013	2013	TBD
August 2010 Exposure Draft Leases	1H 2013 Second Exposure Draft Leases	Consultation	TBD Final Standard Leases
Comment period: 4 months 786 comment letters received Contained proposals for both lessees and lessors	Re-expose proposals Comment period 120 days Focus on revisions to 2010 proposals Contains proposals for both lessees & lessors	Outreach Working group meetings Redeliberations	Effective date: TBD Will contain guidance for both lessees & lessors

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### Preparing for an (Eventual) Leases Standard

- Inventory all leases
  - Donated space (no or nominal rent) excluded
- Assess capitalization threshold
- Monitor the continued developments in the project at [www.fasb.org](http://www.fasb.org)
- Depending on final decisions:
  - Understand any potential impact on debt financial covenants (debt/equity ratios) and any other key financial metrics by which the organization is measured.
  - Understand any potential impact on cost recovery agreements (primarily, equipment leases). The FASB is **very aware** of these issues for NFPs, as well as other Government contractors, etc.

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### Why a NFP: FSP Project?

**Recommended by NAC, part of improving financial reporting**



- Revisit net asset classifications/terminology
- Improve liquidity portrayal
- More clearly communicate NFP performance
- Enhance relevance & clarity of NFP-specific disclosures
- Provide framework for commentary & analysis on operations / financial health

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### FASB NFP Financial Reporting Initiative

**Standards: NFP Statement Presentation**

- Improve net asset classifications
- Reexamine NFP statement standards

**Research: NFP Other Communications**

- The use of such commentary and analysis (MD&A) in conjunction with NFP GAAP statements to tell a "financial story"

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### NFP: Financial Statement Presentation

**What work has been done to date?**

- Formed 21-member resource group
- Presented plan, scope & approach to resource group, NAC, Board (which approved plan)
- First topic: operating measures
  - Completing initial deliberations
- Second topic: net asset classes
  - Beginning discussions with Board



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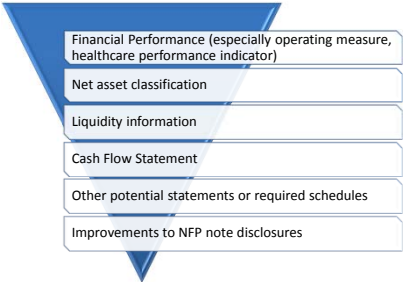
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### Modules



- Financial Performance (especially operating measure, healthcare performance indicator)
- Net asset classification
- Liquidity information
- Cash Flow Statement
- Other potential statements or required schedules
- Improvements to NFP note disclosures

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### Some Challenges

*What transactions & events define performance?*

- Can the Board develop a notion of operations that is seemingly sought by users & preparers of NFP financial statements but for which consensus has been elusive?
  - Current operations
  - Available for current operations
  - Made available for current operations
  - Performance indicator—business-oriented HC entities
  - Others

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### Operating/Nonoperating Distinction

*What did we hear at the most recent NAC meeting?*

- NAC members generally expressed support for:
  - Using relation to mission as a factor to distinguish an intermediate operating measure but not as the sole basis
  - Excluding current period gifts if restricted for purposes other than current period activities
  - Including prior period restricted support when available/ used in current period
  - Excluding "capital" gifts (e.g., gifts for endowment)
  - Excluding items business entities report as part of other comprehensive income (rather than net income)

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### Operating/Nonoperating Distinction

*What did we hear at the most recent NAC meeting?*

- **Some NAC members expressed support for:**
  - Reflecting in operations amounts made available/unavailable by board policies (e.g., bequests, quasi-endowment), but in a transparent way

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### Some Challenges

*Net asset classification: donor-imposed restrictions*

- Do fiduciary duties and restrictions on use of donated assets **require special distinctions**?
- If yes, how and where—notes or face of financial statements?
- Should required net asset classes be modified to help meet user needs for information about:
  - Liquidity and cash flows?
  - Financial performance?

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### Some Challenges

*How might we improve the statement of cash flows?*

- Can indirect method of presenting cash flows from operations be improved?
  - Perhaps aligned with a required intermediate measure of operations
- Should all NFPs be required to use the direct method for presenting cash flows from operations?

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### Some Challenges

*What other statements or schedules should be required?*

- **Should NFPs other than voluntary health and welfare organizations be required to present a statement of functional expenses (matrix of expenses by nature & function)?**
- AICPA NFP Expert Panel recommended this for all NFPs for which contributions are a significant pct. of revenue
- NAC members have expressed mixed views about the utility of this statement

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### Next Steps



- Board deliberations (2013)
- Ongoing outreach with project resource group, NAC and others
- Exposure Draft (ED)—proposed ASU exposed for comments (estimated: late 2013 or early 2014)
- Comment period: more outreach, field visits, testing, roundtables, etc.
- Redeliberations by Board
- Final ASU issuance (estimated: late 2014 or early 2015)

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### NFP: Other Financial Communications (MD&A)

*What work has been done to date?*

- Formed 21-member resource group
- Developed research plan
- Conducted outreach & initial research
- Shared findings & observations with resource group, NAC and others, and FASB Board
- Discussed next steps with Board



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### Current Practice Observations

- Existence varies; where available, often shared via website
- Respondents cite: variable quality & consistency, lack of liquidity & forward-looking information

*Findings coincide with NAC recommendations; framework needed for NFP directors & managers to provide commentary & analysis on financial health & operations*

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### Next Steps



- *Board to issue Invitation to Comment (Discussion Paper) concurrently with ED for NFP Financial Statements project, in late 2013 or early 2014.*
- *Purpose: to solicit broad public input to help the Board decide whether to add a standard-setting project and to help inform direction of a standard-setting project if added.*
- *Feedback may also be useful for re-deliberations of Financial Statements ED*

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### Disclosure Framework Project

**Objective**

- **Improve effectiveness of disclosures in notes to financial statements by clearly communicating the information most important to users of those statements.**
  - ✓ Reducing volume of notes *not* primary focus (audit, legal, regulatory considerations)—but sharper focus on important information will result in reduced volume in most cases.

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### Disclosure Framework – Invitation to Comment

- **Major components**
  - A decision process for the Board
  - A decision process for reporting entities
  - Organization & formatting of notes to financial statements
- **Other items**
  - Interim disclosures



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### Disclosure Framework - Decision Process

<b>Purpose</b>	<ul style="list-style-type: none"><li>• Help the Board identify disclosures with broad relevance</li><li>• Help the Board in setting variable (flexible) disclosure requirements</li></ul>	<b>Entity</b>	<ul style="list-style-type: none"><li>• Provide judgment guidance to help entities</li><li>• Identify disclosures that are and are not relevant in their financial statements</li><li>• Facilitate improvements in organization &amp; formatting of notes</li></ul>
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### Disclosures – Previous NAC Discussions

*Key disclosure consideration: information needs of NFP statement users are often different from equity investors, especially public company equity investors*

- NFP stakeholders (donors, creditors, regulators, etc.) 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
- They also have other concerns that go beyond assessing the prospect for future cash flows

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### Recent NAC Discussions on Disclosure Framework Project

*NAC supports objective, focus on information of most importance to users.*

- **Concerns**
  - Information for assessing prospects for net cash flows to entity appropriate; may not be sufficient for other donor needs
  - Stewardship/accountability
  - How resources have/are being used

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### Next Steps

- Address concerns of comment letter respondents
- Perform additional outreach



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### Revenue Recognition

*Objective: single, principle-based revenue standard*

- **Improve accounting for contracts with customers**
  - More robust framework for recognizing revenue
  - Increased comparability across industries & capital markets
  - Better disclosures

*Converged with IASB on major decisions up to now  
Final standard expected in mid-2013*

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### Revenue Recognition – Project Status

2010	2011	2012	2013
<b>June 2010</b> <b>Exposure draft</b>	<b>November 2011</b> <b>Revised exposure draft</b>	<b>March 2012</b> Comment letter deadline	<b>H1 2013</b> <b>Final standard (ASU / IFRS)</b>
<i>Revenue from Contracts with Customers</i>	<i>Re-exposure of revenue from contracts with Customers</i>	<b>April 2012</b> Roundtables	In June / July
<i>974 comment letters</i>	<i>358 comment letters</i>	<b>May 2012 onwards</b> Redeliberations	Effective: c/y 2017 (public entities) c/y 2018 (nonpublic entities)

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### Revenue Recognition – Core Principles

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

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### Revenue Recognition – Proposed Model

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    graph LR
      A[Identify contract(s) with the customer] --> B[Identify separate performance obligations]
      B --> C[Determine transaction price]
      C --> D[Allocate transaction price]
      D --> E[Recognize revenue when performance obligation is satisfied]
  
```

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### Revenue Recognition: Impact on NFPs

*Scope is contracts with customers. Both contributions and collaborative arrangements are outside scope.*

- Many NFP transactions may be scoped out as being contributions or collaborative arrangements.
- Timing of revenue recognition of those transactions that do fall within scope may not change significantly for many NFPs, though underlying thought pattern (new model) would be different.
  - Industry most to focus on: healthcare
- Most significant change could be the additional disclosures, though nonpublic entities are exempt from many of these

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### Objective

- Make financial statements more useful to decision makers
- Make GAAP for asset and liability classification & measurement easier to understand, use & audit
- Increase comparability with IFRS



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### Assets/Liabilities @ Amortized Cost

For financial assets & financial liabilities measured at amortized cost, public entities would be required to disclose their fair values parenthetically on the face of the balance sheet (except for receivables and payables due in less than a year and demand deposit liabilities).

Nonpublic entities would not be required to disclose such fair value information either parenthetically or in the notes to the financial statements.



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### Going Concern - Background

- Today, auditors are primarily responsible for GC assessments
- U.S. GAAP has no guidance on management's disclosures



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### Going Concern - Background

- Project objective: standardize disclosures by giving management guidance on when & how to disclose GC uncertainties
- FASB issued first ED in 2008
- Second ED issued June 2013



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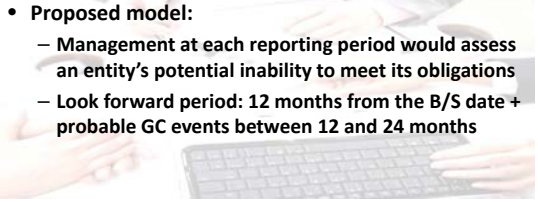
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### Management Assessment of G.C.

- Proposed model:
  - Management at each reporting period would assess an entity's potential inability to meet its obligations
  - Look forward period: 12 months from the B/S date + probable GC events between 12 and 24 months



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### Management Assessment of G.C.

- **Proposed model (continued)**
  - If likelihood is more-likely-than-not *absent* actions outside the normal course of business, start disclosures
  - If likelihood reaches probable, declare substantial doubt (SEC filers only)

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### Nonpublic Entity – Definition

*Previous NAC discussions of where NFPs fall on the public/private continuum*

- **NAC members agree that NFPs share some attributes of private companies (more limited resources), but in many ways, they are generally far more “public”**
  - 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

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### Nonpublic Entity – Definition

*Recent NAC Discussions: Are distinctions among NFPs necessary? If not, might one or more be helpful?*

- Bright-line between public & private NFPs based on public accountability notion unlikely to be helpful
- Bright-line used in GAAP based solely on issuance of publicly traded debt questionable
- FASB should perhaps consider other factors when determining whether a requirement should apply to all or only certain NFP organizations

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**Nonpublic Entity – Definition**

*Are distinctions among NFPs necessary? If not, might one or more be helpful?*

- NFP statement users prefer consistency in accounting requirements that promote key metrics & comparability
- FASB should consider whether practical expedients permitted for private companies are appropriate
- Users may be more flexible for disclosures & deferred effective dates

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**Government Assistance**

*Research effort for potential project. Scope would include all entities, not just NFPs. (Unlike IFRS, GAAP lacks guidance for business entities.)*

- **Key Issues Recently Discussed with the NAC:**
  - Pervasiveness of government assistance in the NFP sector and diversity of practices
  - Possible scope of project, with respect to:
    - Levels of government (federal, state and local, foreign)
    - Forms of assistance (income taxes, property taxes, cost-sharing arrangements, grants, many others)

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**Classification of Sales Proceeds of Donated Financial Assets (EITF Issue 12-A)**

- Final ASU (ASU 2012-05) issued in October 2012
- Provides that an NFP should classify cash receipts from the sale of financial assets that upon receipt are directed without any NFP-imposed limitations for sale, and which were converted nearly immediately 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
- Effective for fiscal years beginning after 6-15-2013, with early adoption permitted

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### Services Received from Personnel of an Affiliate (EITF Issue 12-B)

- Final ASU (ASU 2013-06) issued in April 2013
- Personnel services received from an affiliate (parent/sub or common control) for which the affiliate doesn't charge the recipient NFP should be recognized in the recipient NFP's financial statements, measured at the actual costs incurred by the affiliate
  - Contributed services criteria no longer applicable
  - FV practicability exception in certain circumstances
  - Entities under Topic 954 (healthcare) would report as equity transfer
- Effective for fiscal years beginning after 6-15-2014, with early adoption permitted

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### Obligations Resulting from Joint and Several Liability Arrangements (EITF Issue 12-D)

- Final ASU (ASU 2013-04) issued in February 2013
- Requires an entity to measure such obligations for which the total amount of the obligation is fixed at the reporting date as the sum of: (a) amount the entity agreed to pay on the basis of its arrangement among its co-obligors, and (b) any additional amount the entity expects to pay on behalf of its co-obligors.
- Also requires disclosures about nature and amount of obligation and other information about those obligation
- Effective date:
  - Public entities: f/y beginning after 12-15-2013
  - Nonpublic entities: f/y ending after 12-15-2014
  - Early adoption permitted

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### Questions?



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