Agenda

• The “Here and Now”: Fair Value (FAS 157 and 159) and Endowments & UPMIFA (FSP FAS 117–1)

• The “Just Around the Corner”: The Codification of US GAAP, NFP Mergers & Acquisitions, Derivatives Disclosures, Other

• The “Down the Road a Ways”: IFRS and major FASB/IASB international convergence projects
Recent Pronouncements
Now Effective

• 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 FY 2009–2010

• FAS 159 (Fair Value Option)
• FSP FAS 117–1 (Endowments & UPMIFA)
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: 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: 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
- Maximize use of observable inputs
  - Level 1, Level 2, Level 3 inputs
FAS 157: A Quick Recap

• 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: Key Issues on 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

• **Liabilities**
  • Non-transferability
  • Gains or deterioration of credit standing

• **Disclosures**
  • Sensitivity to inputs
Statement 157: Issues for Higher Ed

• Contributions (pledges) receivable
  – Appropriate discount rate

• Split–Interest obligations (especially charitable gift annuities)
  – Appropriate discount rate

• Alternative investments
  – Liquidity restrictions
Statement 157: Issues for Higher Ed

• Gifts of other non-financial assets
  – Exit price
  – Highest best use
  – Effect of donor restrictions

• Disclosures
  – Classification as to level
  – Level 3 disclosures
FAS 157: Alternative Investments

• The primary issue: relationship of FV to NAV, especially with regard to liquidity restrictions that are an attribute of the investment itself
  – Examples: gates on otherwise redeemable hedge funds; lock-up provisions on private equity (and “evidence” of FV provided by secondary market transactions)

• The AICPA’s Draft Issues Paper, FASB Statement No. 157 Valuation for Interests in Alternative Investments (January 2009)
  – Discusses the above examples and other features that could potentially result in a discount or premium versus NAV
FAS 157: Alternative Investments

- FASB’s short-term project Applying Fair Value to Interests in Alternative Investments
  - Project added to the FASB’s agenda on February 18, in response to suggestions by the FASB’s Valuation Resource Group and input provided by constituents such as NACUBO
  - Looking for cost-beneficial alternatives
  - Proposed FSP released for public comment in late May
  - Final guidance expected in July
FAS 157: Alternative Investments
Summary of Proposed FSP

• Provides guidance for estimating fair value of investments in investment companies that have calculated net asset value per share in accordance with the AICPA Audit and Accounting Guide, *Investment Companies*
  - Would not apply if the fair value of the investment is readily determinable as defined in paragraph 3 of FASB No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
FAS 157: Alternative Investments
Summary of Proposed FSP

- A reporting entity is permitted to estimate the fair value of an investment using net asset value per share without further adjustment if the net asset value per share of the investment is determined in accordance with the AICPA Audit and Accounting Guide, *Investment Companies* as of the reporting entity’s measurement date
FAS 157: Alternative Investments
Additional Guidance

• The following are examples of guidance that may be useful in determining whether net asset value is in accordance with the AICPA Audit and Accounting Guide, *Investment Companies*:
  
  • The investment companies Guide and AICPA Technical Practice Aid, TIS Section 6910, *Investment Companies*, paragraph 29, “Allocation of Unrealized Gain (Loss), Recognition of Carried Interest, and Clawback Obligations”
  
  • Statement of Auditing Standards No. 92 (AU Section 332), “Auditing Derivative Instruments, Hedging Activities, and Investments in Securities” and Auditing Interpretations of Section 332 (AU 9332), “Auditing Investments in Securities Where a Readily Determinable Fair Value Does Not Exist”
  
  • The 2006 AICPA Technical Practice Aid, “Auditing Alternative Investments”
FAS 157: Alternative Investments
Summary of Proposed FSP

• Effective upon issuance, including prior periods for which financial statements have not been issued, and applied prospectively

• A revision from a change in valuation technique or its application shall be accounted for as a change in accounting estimate
  – Disclosure provisions for change in accounting estimate are not required
• The reporting entity should disclose the following information
  – The fair value (determined by applying this FSP, if applicable) of investments within the scope of this FSP, separately disclosing the fair value of investments to which the reporting entity has applied the practical expedient
  – The reporting entity’s best estimate of the remaining life of a finite lived investment
  – The amount of the reporting entity’s unfunded commitments related to its investment
  – The terms and conditions upon which the investor may redeem its investment
  – The circumstances in which an otherwise redeemable investment (or portion thereof) might not be redeemable. Also, for those otherwise redeemable investments that are restricted from redemption as of the reporting’s entity measurement date, the reporting entity shall disclose its best estimate of the restriction against redemption might lapse
  – Any other significant restriction on the ability to redeem or sell the investment at measurement date.
FAS 159  
(Fair Value Option)

• Irrevocable instrument–by–instrument election to carry financial instruments at fair value  
  – After initial year (FY 2008–09), 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

• Higher Ed: probably the most beneficial use would be with split–interest obligations.
FSP FAS 117–1
(Endowments & UPMIFA)

• Final FSP 117–1 issued in August 2008
• Located of FASB Website at www.fasb.org/pdf/fsp_fas117–1.pdf
• Effective for fiscal years ending December 15, 2008
• 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
UPMIFA: Enactment Status

May 12, 2009
FSP FAS 117-1 & UPMIFA: What Hasn’t Changed (Much)?

- Permanently restricted net assets are not diminished by investment losses or organizational appropriations for spending.
  - Rationale: The institution’s permanent fiduciary duty for a fund of permanent duration is unchanged
  - (Short-term) funding/cash management flexibility for legal purposes versus net asset classification for financial reporting purposes

- Instead, temporarily restricted or unrestricted net assets would be charged.
  - Hugely important: that charge is within the endowment, not within operating funds.
FSP FAS 117–1 & UPMIFA: What Has Changed?

• 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

• Composition of endowment by net asset class
• Endowment roll–forward by net asset class

• Also: existing disclosures on nature of restrictions (Statement 117) and underwater situations (Statement 124)
Sample Endowment Composition Disclosure (No Underwater Funds)

Endowment Net Asset Composition by Type of Fund as of June 30, 200X

<table>
<thead>
<tr>
<th></th>
<th>Unrestricted</th>
<th>Temporarily Restricted</th>
<th>Permanently Restricted</th>
<th>Total</th>
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<td>Donor-restricted endowment funds</td>
<td>$ -</td>
<td>$46,380</td>
<td>$95,673</td>
<td>$142,053</td>
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<td>Board-designated endowment funds</td>
<td>6,947</td>
<td>-</td>
<td>-</td>
<td>6,947</td>
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<tr>
<td>Total Funds</td>
<td>$6,947</td>
<td>$46,380</td>
<td>$95,673</td>
<td>$149,000</td>
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</table>
Sample Endowment Composition Disclosure (Underwater Funds)

• Distinguishing board designated endowment from other long-term reserves
  – More of an issue outside of higher education

• Tabular disclosures are about endowment net asset balances, not endowment investment balances
  – More of an issue within higher end because of the NACUBO Endowment Survey
  – May wish to provide a reconciliation in the notes

• Appropriation equates to removal from endowment “ownership”
  – It is not necessarily coincident with either of the following:
    • The actual transfer of cash for spending
    • A reclassification from TRNA to URNA for the institution as a whole (if there are purpose restrictions)
“Just Around the Corner”
The Codification of US GAAP

• Purpose: to combine 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 versus non-authoritative (in lieu of levels a, b, c, and d), in connection with Proposed FAS 162 (R)

• Effective date for the Codification is July 1, 2009
  - One-year public verification phase ended in January 2009 and comments received are currently being addressed
NFP M&A Standard

- Effective date: FY 2010–2011 (mergers or 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 NFP’s and acquisitions (by purchase or gift) of a business by an NFP
NFP M&A Standard

• Tightens the guidance on which combinations of NFP’s can use pooling (carryover basis of accounting)
  – Only those in which the two combining institutions each cede control

• Provides guidance on what the carryover basis entails and requires certain disclosure
  – Important: the initial reporting period may be less than 12 months
NFP M&A Standard

- 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 list) are excluded
  - Goodwill would not be recognized if the acquiree is predominantly funded by contributions and investments
  - Others would recognize goodwill and subsequently test it for impairment under Statement 142
  - Fairly extensive disclosures are required in the year of acquisition and possibly beyond
Statement 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 FY 2009–2010
Some other Short-Term Projects of Interest of Higher Ed

- Disclosures of Certain Loss Contingencies
- Loan Loss Disclosures
- Subsequent Events
- Going Concern
SEC Roadmap for Moving to IFRS

• Announced on August 2008; formal proposal out for comment
• Would allow select global U.S. companies to move to IFRS as early as 2009 (but also provide reconciliation to U.S. GAAP)
• Other public companies would follow in 2014–2016 timeframe
• Based on experience with the early movers and on certain other milestones (including improvements to IFRS from FASB/IASB convergence efforts, stabilization of IASB funding, progress in training and education in US), SEC would make final decision in 2011
• New chairman Mary Schapiro will likely slow down the Roadmap
International Convergence: The Road Ahead

- The movement toward IFRS
- “Principles-Based” (IFRS) versus “Rules-Based” (US GAAP)
- The environment in the United States
- Other changes needed: regulatory, auditing, educational, IASB funding, etc.
- How long a road?
International Convergence: The Road Ahead

- Ideal characteristics of principles-based standards*:
  - No exceptions
  - Core principles (objectives)
  - No inconsistencies
  - Tied to conceptual framework
  - Judgment
  - Minimum guidance

* source: December 2007 speech by Sir David Tweedie (IASB chairman) and Robert Herz (FASB chairman)
International Convergence for NFPs

• Unique consideration for NFPs
  – Impediments:
    • Global flow of donated capital versus global flow of investment capital
    • Dearth of guidance in IFRS concerning contributions
  – Drivers:
    • Comparability with business entity financials, especially in health care

• How long a road and what are the alternatives?
Some Key Joint FASB/IASB Projects

- Conceptual Framework
- Financial Statement Presentation
- Revenue Recognition
- Lease Accounting
- Financial Instruments: Simplification and Improvement
Conceptual Framework Project: Eight Phases

A: Objectives and Qualitative Characteristics
B: Elements and Recognition
C: Measurement
D: Reporting Entity
E: Presentation and Disclosure, including Financial Reporting Boundaries
F: Framework Purpose and Status in GAAP Hierarchy
G: Applicability to the Not-for-Profit Sector
H: Entire Framework
# Financial Statement Presentation Project

<table>
<thead>
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<tbody>
<tr>
<td>Business</td>
<td>Business</td>
<td>Business</td>
</tr>
<tr>
<td>• Operating assets and liabilities</td>
<td>• Operating income</td>
<td>• Operating cash flows</td>
</tr>
<tr>
<td>• Investing assets and liabilities</td>
<td>• Investment income</td>
<td>• Investing cash flows</td>
</tr>
<tr>
<td>Financing</td>
<td>Financing</td>
<td>Financing</td>
</tr>
<tr>
<td>• Financing assets</td>
<td>• Financing income</td>
<td>• Financing asset cash flows</td>
</tr>
<tr>
<td>• Financing liabilities</td>
<td>• Financing expenses</td>
<td>• Financing liability cash flows</td>
</tr>
<tr>
<td>Income taxes</td>
<td>Income taxes on continuing operations (business and financing activities)</td>
<td>Income taxes</td>
</tr>
<tr>
<td>Discontinued Operations</td>
<td>Discontinued Operations, Net of tax</td>
<td>Discontinued Operations</td>
</tr>
<tr>
<td>Equity</td>
<td>Other comprehensive income, net of tax</td>
<td>Equity</td>
</tr>
</tbody>
</table>
Financial Statement Presentation
Project

• Key Principles: cohesiveness between primary statements (financial position, comprehensive income, cash flows) and better disaggregation within the statements

• Some key changes:
  – Treasury activities in financing section
  – Peripheral business activities in investing section
  – Fixed asset acquisitions in business section
  – Income taxes in separate section (on balance sheet)
  – Requirement of direct method for cash flows
Financial Statement Presentation Project

• Also proposed: Reconciliation Schedule (between statements of cash flows and comprehensive income)

• Preliminary Views document issued on October 16, 2008
  
  – 180-day comment period ended April 14, 2009
Revenue Recognition Project

- Aim is to create a single, coherent standard on revenue recognition
- Focus: earned revenue, not contributions
- Pursuing an approach consistent with the definition of revenues in Concepts Statement 6 (changes in assets and liabilities), rather than Concepts Statement 5 (earnings process)
- Preliminary Views document issued December 19, 2008
  - 210-day comment period ends June 19, 2009
Lease Accounting Project

• Comprehensive re-look at current lease accounting standards
  – FAS13: poster child for a standard that needs fixed

• Looking at both lessee and lessor accounting
  – Primary focus is on lessee accounting
Lease Accounting Project

• Pursuing a rights and obligations approach: all (major) leases on balance sheet
  – Lessee: asset (right to use leased item during lease term), liability (obligation to make payments)
  – Lessor: assets (right to receive payments; residual value of leased item, after lease term)

• Preliminary Views document issued March 19, 2009
  – 120 day comment period ends July 17, 2009
Financial Instruments Project

• Key question: Should all financial instruments be reported at fair value, or should the current mixed attributes model be retained and perhaps refined?
  – Mixed attributes: some at fair value, others at amortized cost.
  – Note that there are other possible current value measures besides fair value

• Secondary Question: If we opt for a refined mixed attributes model, should that be based on (a) management intent (trading versus holding), (b) the characteristics of the instrument itself (degree of risk/volatility, etc.). Or (c) a combination thereof?
Thank you for your interest in today’s presentation. Please feel welcome to contact us with any follow up questions.

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