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Upcoming FASB Guidance and Ongoing FASB Projects of Interest to the Not-for-Profit Sector

This is the second of an ongoing series of articles concerning FASB pronouncements and projects of interest to not-for-profits, their auditors, and their constituents. The first article, published in the January 2007 issue of *The FASB Report,* discussed the following pronouncements issued in 2006 and early 2007:

- FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*
- FASB Statement No. 157, *Fair Value Measurements*
- FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*
- FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (issued shortly after publication of the article)
- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*
- FASB Staff Position FAS 126-1, *Applicability of Certain Disclosure and Interim Financial Reporting Requirements for Obligors of Conduit Debt Securities*
- EITF Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43"
- EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)"

That article may be found on the FASB's web site, at www.fasb.org/articles&reports/not-for-profit_tfr_jan2007.pdf. This second article describes some important near-term projects and upcoming guidance.

Deferrals of Recent Guidance

The Board recently approved a one-year deferral of the effective date of Interpretation 48 for all nonpublic entities, unless they have already implemented the Interpretation and issued interim or year-end GAAP financial statements. Consistent with the definition of "public" in FASB Statement No. 109, *Accounting for Income Taxes,* which Interpretation 48 is interpreting and which was amended by FSP FAS 126-1, "nonpublic" would include all not-for-profits without publicly traded conduit debt. Interpretation 48 would thus now be effective for fiscal years beginning after December 15, 2007, for not-for-profits without conduit debt or with only privately placed conduit debt.

The Board also recently approved a one-year deferral of Statement 157 for most nonfinancial assets and nonfinancial liabilities, other than those that are regularly reported or disclosed at fair value on at least an annual basis. Not-for-profits should note that, for example, the latter include real estate and other nonfinancial assets if they are carried at fair value in the endowment or other investment portfolios of not-for-profits, but do not include such assets if they are used in the organization's operations and thus carried at cost (if acquired by purchase) or fair value at the date of donation (if acquired by gift).

These decisions will be exposed for public comment through Proposed FSPs (which, at press time, were slated for release in late November or early December 2007).

Codification

Like other sectors, not-for-profits will benefit from the codification of U.S. GAAP that will be released in draft form in early 2008 as part of the FASB's ongoing efforts to simplify and improve GAAP. In contrast to the current multi-tiered GAAP hierarchy involving separate pronouncements issued over the years by the FASB, the AICPA, and the EITF, the codification integrates all authoritative GAAP in one central, topically organized, electronically searchable place. After a one-year public comment period in which constituents will be given the opportunity to assess and comment on the content and search engine of the codification, the FASB will finalize the codification and it will become the single authoritative source of GAAP for nongovernmental entities, superseding all of the existing, separate standards. Not-for-profits should watch for the release of the draft codification and help "kick the tires."

Omnibus Changes to Consolidation and Equity Method Guidance

As part of the process of condensing and organizing current GAAP into the draft codification, efforts have been made to highlight and address areas where GAAP may be inconsistent or unclear. Three of these areas involve the consolidation and equity method guidance contained in AICPA SOP No. 94-3, *Reporting of Related Entities by Not-for-Profit Organizations,* and the AICPA Audit and Accounting Guide, *Health Care Organizations* (the Health Care Guide).

In September 2007, the FASB released Proposed FSP SOP 94-3-a and AAG HCO-a, *Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations,* for public comment. The Proposed FSP would amend SOP 94-3 and the Health Care Guide to:

- Eliminate the remaining instances of the temporary control exception to consolidation and make two related changes

- Confirm the applicability to not-for-profit organizations of three EITF Issues concerning when to consolidate special purpose entities used in leasing transactions. (The guidance was superseded for business entities by FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, which generally does not apply to not-for-profits.)

- Require use of the equity method of accounting for investments in for-profit partnerships, limited liability companies, and similar entities in which a not-for-profit has more than a minor interest, unless the investments are reported at fair value. (This includes many of the alternative investments in not-for-profit endowment portfolios.)

These changes would eliminate inconsistencies between SOP 94-3 and the Health Care Guide and with other authoritative standards, where appropriate. The requirement to use the equity method for more-than-minor interests would not represent a change in practice for most not-for-profit health care providers, which already use the equity method for such investments. On the other hand, the requirement would represent a change in practice for the minority of other not-for-profits that currently carry such investments at cost rather than at fair value. Not-for-profits that do not wish to use the equity method should switch to fair value, using either the portfolio-wide alternative allowed under the AICPA Audit and Accounting Guide, *Not-for-Profit Organizations* (which covers all not-for-profits other than those within the scope of the Health Care Guide), or the instrument-by-instrument option allowed under Statement 159.

The amendments to SOP 94-3 and the Health Care Guide would be effective for fiscal years beginning after June 15, 2008. The comment period for the proposed FSP ended on November 30, 2007, and a final FSP is expected to be issued in early 2008.

UPMIFA and Net Asset Classification of Donor-Restricted Endowment Funds

At its October 31, 2007 meeting, the Board added a project to its agenda to issue an FSP to provide guidance on the effect of the model Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) on the net asset classification of donor-restricted endowment funds by not-for-profits. This issue has widespread importance to the not-for-profit sector, especially well-endowed organizations, and the users of their financial statements (such as donors, credit rating agencies, and regulators).

The model UPMIFA is intended to modernize the guidance in the Uniform Management of Institutional Funds Act of 1972 (UMIFA), which has been the primary law governing the investment and management of donor-restricted endowment funds in 46 states and the District of Columbia. As of October 1, 2007, 13 states had enacted a version of UPMIFA to replace their version of UMIFA. During the next two to three years, all of the remaining states currently following UMIFA are expected to follow suit.

Among its key changes, UPMIFA contains revised guidelines concerning spending from donor-restricted endowment funds. Those guidelines give not-for-profit organizations more short-term flexibility to handle the types of underwater situations seen in many not-for-profit endowment funds during the stock market decline of 2001–2003. The guidelines do so by eliminating UMIFA's bright-line historic dollar value threshold—an amount below which a not-for-profit could not spend from the fund—in favor of more robust guidance concerning what constitutes prudent spending, with an increased emphasis on the long-term preservation of the fund. That change has raised questions, and generated diverse views, in the not-for-profit sector concerning the effect of UPMIFA on net asset classification of donor-restricted endowment funds.

At the October 31 meeting, the Board decided that, in the absence of any overriding explicit donor stipulations, a portion, but generally not all, of a donor-restricted endowment fund should still be classified as permanently restricted net assets. Consistent with the principle underlying the net asset classification of endowment appreciation that was contained in FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* the permanently restricted portion would be determined by an organization's governing board based on its interpretation of the amount that relevant state law (including the state's UPMIFA) requires the organization to retain permanently, in the long run. And, consistent with the long-term view of this principle, the Board also decided that it would not change the requirement in FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* to charge temporarily restricted and/or unrestricted net assets, rather than permanently restricted net assets, for investment losses (and now, possibly, spending) in underwater situations.

The Board also decided that, to help ensure financial statement transparency, an organization would be required to disclose its interpretation of the relevant state law. The Board also directed the staff to develop other appropriate additional disclosures that may be needed to provide sufficient transparency for funds under UPMIFA.

Not-for-profits should watch for the release of a Proposed FSP for public comment early in the first quarter of 2008.

Mergers and Acquisitions by a Not-for-Profit Organization

The Board has begun its redeliberations of the two Exposure Drafts released in October 2006 in connection with the FASB's ongoing project on not-for-profit mergers and acquisitions. The two EDs, *Not-for-Profit Organizations: Mergers and Acquisitions,* and *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition,* together would require that, with certain modifications, not-for-profits:

- Account for all mergers and acquisitions using the acquisition method (formerly called the purchase method)
- Account for noncontrolling interests (formerly called minority interests) as components of net assets instead of liabilities or mezzanine items
- Apply the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* to all goodwill and intangible assets acquired in mergers and acquisitions.

At its September 19, 2007 meeting, the Board revisited the proposed requirement that all mergers and acquisitions be accounted for under the acquisition method and decided that mergers of not-for-profit organizations should instead be accounted for using the carryover basis. Mergers would be defined as transactions in which two entities combine to form a new legal and/or economic entity and the two entities cede control to the new entity. Conversely, acquisitions would be defined as transactions in which one entity takes control of another entity. The Board will be releasing a limited Exposure Draft, focused on this decision only, for public comment in December or January. The comment period will be 60 days.

Also at the September 19 meeting, the Board rejected a suggestion to allow small nonpublic not-for-profits to use the carryover basis for acquisitions as well.

During the first quarter of 2008, the Board will continue its redeliberations of the two Exposure Drafts, focusing especially on goodwill and certain intangible assets, and on the applicability of the changes made during the redeliberations leading to the issuance of the revised version of FASB Statement No. 141(R), *Business Combinations,* and FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (both issued in December 2007). The FASB currently expects that final Statements for not-for-profits will be issued in mid-2008.

Projects Amending FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities

The FASB currently has two short-term projects on derivative instruments that are of interest to not-for-profits. The objective of the derivatives disclosures project is to 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.

All not-for-profits that use interest rate swaps and other derivative instruments in their debt management, investment, and other activities, should watch for a final Statement during the first quarter of 2008.

The objectives of the accounting for hedging activities project are to:

- Resolve practice issues that have arisen under Statement 133
- Simplify accounting for hedging activities
- Improve financial reporting of hedging activities
- Address differences in the accounting for derivative instruments and hedged items or transactions.

Not-for-profit health care providers for whom hedge accounting often significantly affects amounts reported in the performance indicator should review the Exposure Draft when issued in the first quarter of 2008, and assess and comment on its provisions during the comment period.

Collaborative Arrangements

At its August 2007 meeting, the EITF reached a consensus on EITF Issue No. 07-1, "Accounting for Collaborative Arrangements." Following ratification by the FASB, the Issue was exposed for public comment through October 22. This Issue, which would be effective for years beginning after December 15, 2007, involves joint operating activities without legally separate joint ventures. The Issue would prohibit the use of the equity method of accounting by the parties to such agreements, and instead require that costs incurred and revenue generated from third parties be reflected in each party's income statement (statement of activities). Such "virtual joint ventures" are especially common with not-for-profit health care providers, and indeed the Issue would supersede AICPA Technical Practice Aid 6400.33, nonauthoritative guidance focused on hospital joint operating agreements and which suggests the use of the equity method. A final version of the Issue is expected to be posted to the FASB's website in December.

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Members of the not-for-profit community should check out the Project Activities section of the FASB's website for additional information on these projects, and read each of the pronouncements to gain a more thorough understanding of their requirements and how to implement them.

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