



Latest Developments in Accounting and Auditing for Not-for-Profits

May 4, 2010

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Latest Developments in Accounting and Auditing for Not-for- Profits

Objectives

- Recognize the impact of recently issued and pending accounting/audit guidance for NFP Organizations

Agenda

- FASB Codification (SFAS 168/ASC 105)
- Accounting for uncertainty in income taxes (FIN 48/ASU 2009-6)
- Mergers & Acquisitions (SFAS 164)
- Investment in Certain Entities That Calculate Net Asset Value per Share (ASU 2009-12)

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FASB Codification (SFAS 168/ASC 105)



Description

- The *FASB Accounting Standards Codification™* ("Codification") is the single source of authoritative nongovernmental U.S. GAAP, except for SEC guidance
- It is included in a topical online research system
- It eliminated levels a through d GAAP and replaced with authoritative and nonauthoritative
- Statement 168 was the last numbered Statement that the FASB will issue

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Why FASB developed the Codification



- To address weaknesses identified in previous GAAP structure
 - U.S. GAAP was unwieldy, difficult to understand, and difficult to use
 - Appropriate authoritative guidance was difficult to retrieve under previous structure, with numerous authoritative standards from various standard-setters
- To simplify standard-setting process and align with FASB's objectives

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Effective date and transition

- The Codification was **launched** on July 1, 2009
- The Codification is **effective** for financial statements for interim and annual periods ending after September 15, 2009
- Significant transitional issues are not expected, except if a nonpublic entity is adopting the AICPA TIS guidance on software revenue recognition

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Changes

- Codification was **not intended** to change U.S. GAAP
- Language from the original pronouncements was edited for consistency and certain words were changed (for example, "should" and "shall" were replaced with "must" and "will")

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Guidance included in the Codification

- Standards included in Levels a – d of the previous U.S. GAAP hierarchy
- Guidance from the FASB, EITF, Derivative Implementation Group, Accounting Principles Board, and AICPA
- Certain guidance that was not previously considered authoritative GAAP has been included in the Codification and thus made authoritative

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Updates

- The Codification will be updated by Accounting Standards Updates (ASUs) issued by the FASB
- These will include:
 - Background
 - Basis for conclusions
 - Update instructions
- ASUs are not authoritative in their own right
- ASUs may be accessed via the FASB website
- ASUs are numbered by the year and a sequential identifier (for example, 2009-01)

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Actions to take

- Obtain access and become familiar with the Codification
- Update references in accounting policies and disclosures
- Discuss anticipated changes with your auditors
 - Evaluate whether it is an error or a change resulting from change to literature

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Updating policies and disclosures

- Accounting policy documentation should be updated to replace legacy references to authoritative literature
- Financial statement disclosures must be updated to replace legacy references to authoritative literature
 - Plain English
 - Codification references

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Disclosures – original

In July 2006, the FASB issued FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109* (FIN 48). FIN 48, which clarifies FASB Statement No. 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the University's financial statements. On initial application, FIN 48 will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying FIN 48 will be reported as an adjustment to net assets at the beginning of the period in which it is adopted. The Entity is currently evaluating the impact on its financial statements and related disclosures of adopting FIN 48.

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Disclosures - revised, plain English

In July 2006, the Financial Accounting Standards Board (FASB) issued guidance on accounting for uncertainty in income taxes which establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the entity's financial statements. On initial application, this guidance will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying the new guidance will be reported as an adjustment to net assets at the beginning of the period in which it is adopted. The Entity has not yet completed its evaluation of the impact on its financial statements of adopting this guidance and, as a result, is not able to estimate the effect the adoption will have on its financial position and results of operations

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Accounting changes

- If an accounting change results from adopting the Codification, it should be accounted-for as a change in accounting principle or correction of an error under ASC 250, *Accounting Changes and Error Corrections*
- It is not anticipated that there will be changes in accounting principles due to the Codification, outside of those related to nonpublic entities' adoption of portions of AICPA TIS 5100

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Accounting for uncertainty in income taxes (FIN 48)

Refresher

- FASB issued Interpretation 48 (FIN 48), *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*, on July 13, 2006
- FIN 48 clarifies SFAS 109, *Accounting for Income Taxes*, to indicate a criterion that an individual tax position would have to meet for some or all of the benefit of that position to be recognized in an entity's financial statements
- The Interpretation provides a process for evaluating a position for recognition and measuring the benefit recognized

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Effective date



- Previously deferred under FIN 48-3, for annual reporting periods beginning after December 15, 2008.
- "Nonpublic" organizations do not include those who have debt traded in a public market including **conduit bond obligors** for conduit debt securities that are traded in a public market or organizations who file f/s with a regulatory agency in preparation of the sale of any class of securities.

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"Tax benefits"

- FIN 48 refers to recognition of a "tax benefit" in an entity's financial statements
- For tax-exempt organizations, the **"tax benefit"** recorded is generally the non-taxability of related revenues, due to the nature of the activity generating the revenue and the overall tax exemption granted to the organization
- **Tax benefit** can also refer to expenses that are deducted in calculating net taxable income

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"Unit-of-Account"

An individual tax position is the unit of account for applying FIN 48:

The determination of what constitutes an individual tax position (unit of account) may directly affect the assessment of the uncertain tax position and is a matter of professional judgment. In making that determination, the financial statement preparer should consider:

- The level at which the entity accumulates information to support the tax return
- The level at which it expects tax authorities to address the issues during an examination

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The term "tax position" includes...

- A position taken in a tax return
 - Already filed
 - To be filed
- Decisions not to file returns (990-T, state returns)
- Allocation or a shift of income between jurisdictions
- Decision to classify a transaction, entity, or other position in a tax return as tax exempt
- Characterization or decision to exclude reporting income in a tax return
- Expense allocation methodology (related to UBI and related entities)
- Validity of NOL (net operating loss) carry-forwards

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Examples of income tax exposure

Unrelated business activities:

- Unsustainable expense allocations
- Too much lobbying activity
- Any political activity

Consequence:

- **Retroactive** loss of tax-exempt status

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Recognition and measurement of tax benefits

Requires two step analysis of each position

1. Recognition

Is the tax position "more likely than not" sustainable upon audit?

"MLTN Recognition Threshold"

No: Then no initial recognition of tax benefit



Yes: Then proceed to measurement

2. Measurement

Determination of the amount of benefit to be recognized in the financial statements

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Unrelated business income

- An organization should **evaluate each of its income-producing activities** to determine whether a tax examination would more-likely-than-not determine that the transactions associated with the activity are tax exempt
- For unrelated business activities, the determination of taxable income and the deductibility of expenses should also be evaluated

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Cataloguing tax positions

Best practices would include:

In reviewing the documents, each position taken should be catalogued and evaluated into one of the following three categories:

1. Highly certain – virtually no tax risk, less documentation needed, brief description as to why the tax law applies to the facts and circumstances
2. Uncertain – those other than highly certain
3. Immaterial – not currently material, but should be monitored should they become material (i.e. materiality of possible effect of a tax position on the financial statements)

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Disclosures, as amended

- FIN 48 requires qualitative and quantitative disclosures, including:
 - Information concerning tax positions for which a material change in the unrecognized tax benefit liability is reasonably possible in the next 12 months
 - The total amounts of interest and penalties (1) recognized in the statement of activities and (2) recognized in the statement of financial position
 - Open tax years by major jurisdiction

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Mergers and Acquisitions (SFAS 164)



Overview

- Provides guidance on accounting for a *combination of not-for-profit entities*, which is a transaction or other event that results in a not-for-profit entity initially recognizing another not-for-profit entity, a business, or a nonprofit activity in its financial statements.
- Applies to a combination that meets the definition of either a *merger of not-for-profit entities* or an *acquisition by a not-for-profit entity*.

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Mergers and Acquisitions

Overview

- This Statement does not apply to:
- a. The formation of a joint venture
 - b. The acquisition of an asset or a group of assets that does not constitute either a business or a nonprofit activity
 - c. A combination between not-for-profit entities, businesses, or nonprofit activities under common control
 - d. A transaction or other event in which a not-for-profit entity obtains control of another entity but does not consolidate that entity, as permitted or required by AICPA Statement of Position 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*, or AICPA Audit and Accounting Guide, *Health Care Organizations*

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Mergers and Acquisitions (SFAS 164)

Overview

- Establishes principles and requirements for how a not-for-profit entity:
 - a. Determines whether a combination is a merger or an acquisition
 - b. Applies the carryover method in accounting for a merger
 - c. Applies the acquisition method in accounting for an acquisition, including determining which of the combining entities is the acquirer
 - d. Determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of a merger or an acquisition

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Mergers and Acquisitions (SFAS 164)

Overview

- Defines an acquisition by a not-for-profit entity and establishes guidance similar to ASC 805, *Business Combinations*, for acquisitions involving not-for-profit entities
- Amends ASC 350, *Intangibles – Goodwill and Other* (Statement 142), and ASC 810-10, *Consolidation* (ARB 51), to make them fully applicable to not-for-profit entities

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Mergers and Acquisitions

Effective Date

- This Statement is effective for:
 - Mergers for which the merger date is on or after the beginning of an *initial* reporting period beginning on or after December 15, 2009
 - Acquisitions for which the acquisition date is on or after the beginning of the first *annual* reporting period beginning on or after December 15, 2009.
- It may not be applied to mergers or acquisitions before those dates.

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Determining Whether a Combination Is a Merger or an Acquisition

- Requires use of the carryover method to account for a *merger of not-for-profit entities*, which is a combination in which the governing bodies of two or more not-for-profit entities cede control of those entities to create a new not-for-profit entity.
- In contrast, the acquisition method must be used to account for an *acquisition by a not-for-profit entity*, which is a combination in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses

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Disclosures - Merger

The new entity shall disclose the following information for the merger that resulted in its formation:

- a. The name and a description of each merging entity
- b. The merger date
- c. The primary reasons for the merger
- d. For each merging entity:
 - (1) The amounts recognized as of the merger date for each major class of assets and liabilities and each class of net assets
 - (2) The nature and amounts, if applicable, of any significant assets (for example, conditional promises receivable or collections) or liabilities (for example, conditional promises payable) that GAAP does not require to be recognized.
- e. The nature and amount of any significant adjustments made to conform the individual accounting policies of the merging entities or to eliminate intraentity balances

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Disclosures – Acquisition

The acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

- a. The name and a description of the acquiree.
- b. The acquisition date.
- c. If applicable, the percentage of ownership interests, such as voting equity instruments, acquired.
- d. The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquiree.
- e. A qualitative description of the factors, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition, or other factors, such as the nonrecognition of collections, that make up either:
 - (1) The goodwill recognized; or
 - (2) The separate charge recognized in the statement of activities

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Disclosures – Acquisition

f. The acquisition-date fair value of the total consideration transferred (or if no consideration was transferred, that fact) and the acquisition-date fair value of each major class of consideration, such as:

- (1) Cash
- (2) Other tangible or intangible assets, including a business or subsidiary of the acquirer
- (3) Liabilities incurred, for example, a liability for contingent consideration.

g. For contingent consideration arrangements and indemnification assets:

- (1) The amount recognized as of the acquisition date
- (2) A description of the arrangement and the basis for determining the amount of the payment
- (3) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

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Disclosures – Acquisition

h. For acquired receivables not subject to the requirements of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* :

- (1) The fair value of the receivables
- (2) The gross contractual amounts receivable
- (3) The best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, contributions, direct finance leases in accordance with Statement 13 , and any other class of receivables.

i. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed.

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Disclosures – Acquisition

j. For assets and liabilities arising from contingencies recognized at the acquisition date:

- (1) The amounts recognized at the acquisition date and the measurement basis applied (that is, at fair value or at an amount recognized in accordance with Statement 5 and Interpretation 14)
- (2) The nature of the contingencies.

An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature.

k. For assets and liabilities arising from contingencies that have not been recognized at the acquisition date, the disclosures required by Statement 5 if the criteria for disclosures in that Statement are met. The disclosures, if any, required by this paragraph and by paragraph 86(j) shall be included in the note that describes the acquisition.

l. The total amount of goodwill that is expected to be deductible for tax purposes.

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Disclosures – Acquisition

- m. The amount of collection items acquired that are recognized in the statement of activities as a decrease in the acquirer's net assets in accordance with paragraph 39.
- n. The undiscounted amount of conditional promises to give acquired or assumed and a description and the amount of each group of promises with similar characteristics, such as amounts of promises conditioned on establishing new programs, completing a new building, or raising matching gifts by a specified date.
- o. For transactions that are recognized separately from the acquisition of assets and assumptions of liabilities in the acquisition (paragraph 67):
 - (1) A description of each transaction
 - (2) How the acquirer accounted for each transaction
 - (3) The amounts recognized for each transaction and the line item in the financial statements in which each amount is recognized
 - (4) If the transaction is the effective settlement of a preexisting relationship, the method used to determine the settlement amount.

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Disclosures – Acquisition

- p. The disclosure of separately recognized transactions shall include the amount of acquisition-related costs, the amount recognized as an expense, and the line item or items in the statement of activities in which that expense is recognized. The amount of any issuance costs not recognized as an expense and how they were recognized also shall be disclosed.
- q. If the acquisition results in an inherent contribution received, a description of the reasons that the transaction resulted in a contribution received
- r. For each acquisition in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date:
 - (1) The fair value of the noncontrolling interest in the acquiree at the acquisition date
 - (2) The valuation technique(s) and significant inputs used to measure the fair value of the noncontrolling interest.

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Disclosures – Acquisition

- s. In an acquisition achieved in stages:
 - 1. The acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date
 - 2. The amount of any gain or loss recognized as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the acquisition (paragraph 60) and the line item in the statement of activities in which that gain or loss is recognized

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ASU 2009-12 – Investments in certain entities that calculate net asset value per share (or its equivalent)

- Provides guidance for investors using the net asset value (NAV) per share to estimate the fair value of alternative investments. Entities with investments within the scope of ASC 820, are permitted, but not required, to use NAV per share as a practical expedient for fair value
- Applies to investments for which:
 - Fair value is not readily determinable
 - The investee meets the criteria of an investment company or reports its results under principles consistent with investment company guidance
 - It is not probable the reporting entity will sell the investment for an amount different than the NAV per share
- The decision to use NAV as a practical expedient is made investment by investment

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ASU 2009-12 – Investments in certain entities that calculate net asset value per share (or its equivalent) – (cont)

- Provides guidance for determining classification of investments
 - Level 2 – Investment can be redeemed at NAV
 - Level 3 – Investment cannot, now or in the future, be redeemed at NAV
 - Level 2 or 3 – Investment cannot currently be redeemed at NAV but might be redeemed at NAV in the future
- Entities must disclose
 - The nature and risks of the investments and whether it is probable the investments will be sold at a price other than NAV per share
 - Disclosures for each major category include information about:
 - Redemption provisions
 - Estimated distributions
 - Unfunded commitments

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ASU 2009-12 – Investments in certain entities that calculate net asset value per share (or its equivalent) –(cont)

- The amended guidance in ASC 820 is effective for interim and annual periods ending after December 15, 2009
- In the period of adoption, entities must disclose the change in valuation technique and related inputs, if any, with the amount of effect, if practicable

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ASU 2009-12 – Investments in certain entities that calculate net asset value per share (or its equivalent) –(cont)

AICPA Technical Practice Aid

- AICPA recently issued Technical Practice Aids (TIS Section 2220, *Long Term Investments*)
- Focus on –
 - Applicability of the practical expedient
 - Determining whether NAV calculated in accordance with measurement principles of ASC 946
 - Situations where company needs to adjust NAV
 - Disclosures
 - Guidance when expedient not used or not available

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Notes

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